



IN THE INCOME TAX APPELLATE TRIBUNAL, RAJKOT BENCH, RAJKOT  
BEFORE DR. ARJUN LAL SAINI, ACCOUNTANT MEMBER  
AND  
SHRI DINESH MOHAN SINHA, JUDICIAL MEMBER  
आयकरअपीलसं./ITA No.80/RJT/2021  
(निर्धारणवर्ष / Assessment Year: (2016-17)  
(Hybrid Hearing)

Madhuram Construction Co. Shop No.401, 4 <sup>th</sup> Floor, The Garden Iconn, ZanzardaChokdi, Zanzarda Road, Junagadh-362 001	बनाम Vs.	Principal Commissioner of Income Tax-1, Rajkot, RoomNo.101, 1 <sup>st</sup> Floor, "Aayakar Bhavan," Race Course Ring Road, Rajkot-360 001
स्थायीलेखासं./जीआइआरसं./PAN/GIR No.: AADFM 3116 E		
(अपीलार्थी/Appellant)		(प्रत्यर्थी/Respondent)

Assessee by :Shri Vimal Desai, AR  
Respondent by :Shri Shramdeep Sinha, CIT.DR  
Date of Hearing : 21/10/2024  
Date of Pronouncement : 13 /01/2025

**आदेश / O R D E R**

**PER DR. A. L. SAINI, AM:**

By way of this appeal, the assessee has challenged the correctness of the order passed by the Learned Principal Commissioner of Income Tax-1, Rajkot [in short 'the Ld. PCIT'], dated 30.03.2021, under section 263 of the Income Tax Act, 1961 [hereinafter referred to as 'the Act'], for the Assessment Year (AY) 2016-17.

2. The grounds of appeal raised by the assessee are as follows:

*"1. The order u/s 263 of the Act is bad in law.*

*2. The learned Pr. CIT has erred in law as well as on facts in not considering the submissions of the appellant on the strength of which the assessment order was neither erroneous nor prejudicial to the interest of revenue and therefore, the provisions of Section 263 of the Act were not applicable to the case of the appellant.*

*3. The learned Pr. CIT has erred in law as well as on facts in setting aside the assessment order passed by the ld. assessing officer u/s 143(3) of the Act and directing de-novo*



*assessment regarding verification of issues viz., increase in labour expenses & sub-contract expense, fall in the NP ratio and increase in sundry creditors.*

*The appellant craves leave to add, alter, amend, delete or withdraw one or more grounds of appeal.”*

3. Succinctly, the factual panorama of the case is that assessee before us is a construction company and had filed his return of income on 16-10-2016, showing therein income of Rs. 2,95,21,590/-. The case was selected for scrutiny under Manual (compulsory) scrutiny to verify whether additional income of Rs.1,90,24,350/- disclosed during the survey was offered to tax or not.

4. Later on, Learned Principal Commissioner of Income Tax, [in short ‘the Ld. ‘PCIT’], exercised his jurisdiction under section 263 of the Income Tax Act, 1961. On perusal of records, it was noticed by the Ld. PCIT, that during the previous year 2015-16, relevant to assessment year (A.Y.) 2016-17, the assessee had claimed labour expenses of Rs.8,50,39,942/- (approximately 19 % of contract work income) in the profit and loss account for the year under consideration, as against Rs.6,97,73,400/- (approximately 9 % of contract work income) for the assessment year (A.Y.) 2015-16 and out of which a nominal ad-hoc disallowance of Rs.5,00,000/- has been made by the assessing officer during the assessment proceedings. Further, during the year, the assessee - firm had claimed sub contract expenses of Rs.16.57 crore (approximately 38 % of contract work income) as against Rs. 20.47 crore (approximately 27 % of contract work income) for the A.Y. 2015-16. Also, Net Profit ratio before interest and remuneration fallen drastically over the years. Further, the firm had shown huge amount of sundry creditors of Rs.14.42 crores as against direct expenditure claim of Rs.47.10 crore. On further perusal of record, it was noticed by Ld. PCIT, that the assessing officer had not examined these issues during the assessment proceedings properly.



These facts indicate that various claims of expenses were not properly examined by the assessing officer during the assessment proceedings. In view of the above, a notice u/s. 263 of the Act, dated 28.12.2020, was issued and served upon the assessee, requesting it to show- cause, as to why the order passed u/s 143(3) of the Act, on 29.11.2018, should not be treated as erroneous in so far as it is prejudicial to the interests of Revenue and accordingly, why it should not be revised u/s 263 of the Act.

5. In response to the above notice of learned PCIT, the assessee submitted its reply before the Ld. PCIT, which is reproduced below:

*“It has been stated in the first contention that there was increase in labour expenses (from 9% to 19% of direct contract income) and sub-contract expenses (from 27% to 38% of direct contract income) in the year under consideration as compared to immediately preceding year.*

*In this regard, it is most respectfully submitted that the above contention is improper, wrong in terms of calculation and in disregard of the nature of business.*

*We are a contractor. Besides government contacts, we are undertaking contracts of behalf of private parties and also doing sub-contract work on behalf of others. Our contract work mainly involves 3 ingredients viz, construction material, labour expenses and sub-contract expenses. Depending upon the nature and requirement of a particular contract, the composition of these 3 ingredients keeps on fluctuating. For example, composition of labour is high in metalling contract work whereas composition of material is high in asphalt contract work.*

*In the show cause notice, the percentage of labour expenses and sub-contract expenses has been worked out only with reference to direct contract work income. This working is incorrect and erroneous due to the following two reasons:*

*(A). Even for sub-contract work income and other construction income, the labour expenses or sub-contract work expenses have to be incurred. Hence, it is not correct to work out percentage of labour expenses and sub-contract work expenses only with reference to direct contract work income. This gives distorted picture.*

*(B). Material is also a significant ingredient which changes according to the kind of contract work and also affects the labour expenses and/or sub contract expenses. In some of the contracts such as metalling work, composition of labour remains high whereas in some other such as asphalt work, the composition of material remains high. It may please be appreciated that in the year under consideration material cost as a percentage of total contract work income was reduced to 40.55% (21,71,70,958\*100/53,55,17,397) as compared to 52,73%*



(39,95,12,146\*100/75,76,61,198) in the preceding year. This indicates that contract work involving more labour was carried out in the year under consideration as compared to preceding year and that is why material expense in terms of percentage was reduced. In your calculation, this vital aspect has remained to be considered and therefore, the working is erroneous and incomplete.

5.Thus, in view of the above, it is respectfully submitted that the working in show cause notice suffers from aforesaid infirmities and such working is not only incorrect but also incomplete and the resultant picture is not logical.

6.The ideal and rational way to compare the contract work of the year under consideration with that of preceding year is to compute GP from, such contract account of respective year. In the audit report of respective year, we have furnished separate contract account for that year. The calculation of GP would take care of all 3 vital ingredients viz. construction material, labour cost and subcontract expenses and all type of contract work income are also included therein. Thus, GP would remove the infirmities which are there in your working and provide a rational and truly comparable picture for both the years.

7.We are furnishing hereunder a comparative statement of GP from such contract account of both the years. It may please be appreciated from the said chart that the GP for the year under consideration is better as compared to preceding year.

Sr. No.	Particular	A.Y.2016-17 (Amount Rs. )	A.Y.2015-16 (Amount Rs.)
1	Gross profit as per contract A/c	8,70,08,151	8,39,32,876
2	Less : Income declared during the survey	1,90,24,350	-
3	Net Gross profit from contract work (1-2) - (A) .	6,79,83,801	8,39,32,876
4	Gross receipts from contract work:		
	a) Contract work income	44,02,52,302	75,44,57,792
	b) Sub contract income	9,38,54,535	32,03,406
	c) Other construction income	14,10,560	
	d) Material sales	31,23,533	24,85,273
	Gross receipts of contract work = a) + b) + c) + d) = (B)	53,86,40,930	76,01,46,471
5.	Gross profit ratio (A/B)	12.62%	11.04%



*In view of the above, it is respectfully submitted that the first contention in the show cause notice is based on incorrect and incomplete working. **The correct working as aforesaid clearly shows that the picture of contract work in the year under consideration is better than the preceding year.** Hence, there is no good ground or logic for drawing any adverse inference on the basis of isolated view of labour expenses or sub-contract expenses.*

*Second contention:*

*1. In the second contention, it has been stated that the net profit before interest and remuneration has fallen over the years.*

*2. In this regard, it is submitted that this issue was examined by the assessing officer, and the same was duly explained to the AO in the assessment proceedings. We are enclosing herewith our submission dated 26,11.2018 before the A.O, in the course of assessment proceedings wherein this issue was clarified in detail.*

*3. As the A.O. had already examined this issue in assessment proceedings after due application of mind, the revision u/s 263 on the contention that this issue was not examined by the A.O, in assessment proceedings is not correct.*

*4. Further, it may please be noted that fall in NP ratio in earlier years has been examined in the assessment for earlier years and the same has attained finality. Hence, such decline in earlier years cannot be subject matter of revision proceedings for the year under consideration as proceedings u/s 263 are always year specific*

*5. As regards decline in NP ratio before interest and remuneration to partners for the year under consideration as compared to preceding year, it may please be noted and appreciated that the reason for such decline is not attributable to any expenses. The labour exp. and sub-contract exp, have no co-relation with this issue as they form part of GP and the GP in the year under consideration is better as compared to preceding year. In fact, such decline in NP ratio is attributable to sharp decline in gross receipts from contract work. In the preceding A.Y. 2015-16, the gross receipts were Rs,76,01,46,471/- which were significantly reduced to Rs.53,86,40,930/- in the year under consideration registering a sharp fall of around 30%. In such circumstances, the NP ratio reduced by around 1% (from 5.19% to 4.04%). When the gross receipt falls at such sharp rate, it is inherent that the NP ratio comes down. The reason for the same is that some of the expenses (such as staff salary, interest, remuneration, electricity, insurance, depreciation, repair etc.) are fixed in nature and when they are shared by lower amount of gross receipts, the NP ratio always goes down. In our case, such decline is only around 1% which is quite reasonable considering that there substantial decline of around 30% in gross receipts. Hence, no adverse inference on this count is justified.*

*6. In view of the above, it is respectfully submitted that the second contention for revision u/s 263 is factually incorrect and it is based on misconceived impression that the NP has reduced due to expenses which is not correct. Hence, we pray that this contention may please be dropped.*

*Third contention;*



1. In the third contention, it has been stated that there were huge sundry creditors of Rs. 14.42 crores as against direct expenditure of Rs. 47.10 crores.

2. In this regard, we wish to submit that the quantum of creditors as compared to direct expenses is reasonable considering the pattern and practice in our business. In the creditors, major amounts are in respect of sub-contractors. It is a general practice to keep the dues of sub-contractor pending until we receive the payment of our contract work from our parties. Our major customer is Government itself and it takes time and lengthy formalities before we receive payment from Government in respect of our contract work. Till then, we do not make payment to sub-contractors. This is a well accepted term in our business and your goodself will find this feature in case of every government contractor.

3. From the balance sheet as on 31.03,2016, it may please be seen that there was Work-in- progress to the extent of Rs. 12.23 crores and debtors of Rs. 6.52 crores aggregating to Rs. 18.75 crores. As against this, the figure of creditors of Rs. 14.42 crores is clearly justified.

4. We are also furnishing hereunder comparative figures of creditors to direct expenses from which it can be observed that the figures are comparable and there is no major variance in the ratio:

Particulars	AY 2016-17	AY 2015-16	AY 2014-15
Creditors (A)	14,42,52,531	17,85,12,637	18,86,96,360
Direct expenses (B)	47,10,40,364	67,65,14,295	71,48,10,934
Ratio (A/B*100)	30.62%	26.39%	26.40%

5. It can be seen from the above that the ratio of creditors to direct expenses is broadly comparable and minor changes are only on account of change in scale. The quantum of creditors is routine in nature and there is nothing unusual or abnormal appearing on comparison.

6. Finally, it is also submitted that mere mentioning the figure of creditors as compared to direct expenses without anything more indicates nothing. Such a statement, without any sort of comparison or without there being any adverse finding against creditors, does not lead anywhere. There cannot be any revision of assessment order on such a primary contention.”

6. However, Id. PCIT rejected the above contention of the assessee and observed that no specific figures have been furnished by the assessee and assessee's reply is based on hypothesis. If the assessee wanted to prove that there is no increase in labour charges it should have come up with details and not general explanations. Be that as it may, is fact on records that the assessing officer has failed to inquire into abrupt increase in



labour expenses and therefore, the order passed by the assessing officer is prejudicial to the interest of the revenue and erroneous. The Id. PCIT noticed that assessee has failed to justify the increase in labour expense. The contention of the assessee that the issue regarding fall of profit was examined by the assessing officer in the course of proceedings is also not correct. The assessee has submitted its explanation during the course of assessment proceedings, however, the same is not properly inquired into by the assessing officer. The assessee's argument that the reasons for decline is not attributable to any expenses and the labor expenses and sub-contract expenses have co-relation is also irrelevant. The decline in gross profit has nothing to do with the decline in turnover of contract. In fact the decline net profit is due to higher claim of expenses which has not been properly examined by the assessing officer. The assessee has also tried to justify the figure of sundry creditors by comparing the same with the work in progress. This is however not relevant when the genuineness of huge sundry creditors has not been properly verified by the assessing officer. In the light of the above facts, the learned PCIT held that the assessment order is passed without making proper inquiries or verification which should have been made by the assessing officer during the assessment proceedings. Resultantly, the order passed by the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue. Therefore, Id. PCIT directed the assessing officer to make a fresh assessment order only to the extent of the issues discussed (supra).

7. Aggrieved by the order of Ld. PCIT, the assessee is in appeal before us.

8. The Ld. Counsel for the assessee, argued that there is no independent view of the Ld. PCIT, as he has merely initiated the proceedings, based on the facts, which were already examined by the assessing officer. The assessing officer examined contract work which involves three ingredients



viz. construction material, labour expenses and sub-contract expenses. The assessee has submitted comparative chart of gross profit (GP) for the assessment year (AY) 2016-17 and 2015-16, to explain the gross profit and assessee explained that the GP result is better than the last year. The assessee also explained the quantum of creditors as compared to direct expenses. Therefore, all the issues raised by the Id. PCIT, were already examined by the assessing officer. While passing the revisionary order, no any new findings by the Ld. PCIT have been given, therefore, based on the same set of facts, the proceeding u/s 263 is not permitted. All the related evidences were kept on records during assessment proceedings and based upon which the assessing officer had taken a plausible view which is not permitted to be replaced with the view of the Ld. PCIT. Thus, the allegation is made without considering the various inquiries made by the assessing officer. Hence, order of the Id. PCIT may be quashed.

9. On the other hand, the Ld. CIT-DR for the Revenue has primarily reiterated the stand taken by the Ld. PCIT, in the order passed under section 263 of the Act, which we have already noted in our earlier para and is not being repeated for the sake of brevity.

10. We have heard the rival contentions, perused the material on record and duly considered facts of the case in the light of the applicable legal position. We find that assessee under consideration is involved in contract business and it undertakes the contract on behalf of private parties, as well as sub-contract, from others and the contract work involves three ingredients viz: (i) construction material, (ii) labour expenses and (iii) sub-contract expenses and therefore depending upon the nature and requirement of a particular contract the components in respect of these three ingredients keeps fluctuating. The assessee has also submitted comparative chart of Gross profit (GP) for the assessment year (AY)



2016-17 and 2015-16 and explained that the gross profit (GP) result is better than the last year. As regard sundry creditors, the assessee explained that the quantum of creditors as compared to direct expense is reasonable considering the pattern and practice of the business. We also find that way of doing business in the same industry, may be slightly different because of availability of material, labour and water etc, in the particular region. We note that during assessment proceedings, the assessing officer issued notice u/s 142(1) of the Act, wherein assessee was asked to furnish the following details and documents (the contents of the show- cause notice are reproduced below to the extent applicable to our analysis):

*“3. In respect of all new and additional unsecured loans/deposits accepted by the firm during the year (including the accounts squared up within the previous year itself) furnish*

***a. date-wise account in books (also showing mode of payment) duly confirmed by lender,***

*b. specify complete address, identity, proof, PAN & Assessing Officer of lender & evidence to show availability of investible surplus in the hands of lender and*

*4. Please furnish the details of New capital introduced by the partners and source thereof along with bank statement/pass book, copy of return, capital a/c and balance sheet for FYs 2014-15 & 2015-16 of all the partners*

***5. Reasons for fall in gross profit margin in detail, if any, may be explained with supporting evidences.***

***6. Please furnish details ledger account of expenses debited to trading/profit and loss account in excess of Rs.50,000/-***

*7. Please furnish the inventory of opening and closing stock. Also give the supporting evidence for valuation of closing stock.*

11. In response to the above notice of the assessing officer, the assessee submitted its detailed reply, along with documents and supporting evidences before the assessing officer, which is placed at paper book page number 16. The assessee submitted in its reply, the details of the creditors



and unsecured loans, reason for fall in gross profit, comparative chart of gross profit, product mix, showing contract- work, sub-contract work, miscellaneous contract work and material etc. The assessee also submitted the details of party-wise purchases and creditors. Therefore, we find that various issues raised by the Id. PCIT were examined by the assessing officer. Hence, assessing officer conducted necessary enquiries and then framed the assessment order, therefore the order of the assessing officer should not be considered erroneous.

12. In respect of issue raised by Ld. PCIT, vide in para-5 of the revision order under section 263 of the Act, wherein Id. PCIT raised the issue about construction labour expenses. In this respect, the findings of the assessing officer, which is mentioned in the assessment order, itself, is reproduced below:

*“6. During the course of assessment proceedings, in response to notice u/s 142(1) of the Act dated 19.11.2018, the AR of the assessee attended and produced books of accounts. It is seen from the P & L a/c of the assessee that Construction Labour Exp. of Rs.8,50,39,942/- has been debited. On verification of relevant ledger account and vouchers, it was found that the construction labour expenses includes payments made on the basis of self made voucher of various sites which does not contain complete details of work done and rate at which payment is made, hence, were not fully verifiable. Considering this aspect, the AR of the assessee was asked as to why an estimate disallowance of Rs.5,00,000/- out of contract labour expenditure should not be made. The assessee’s AR sated that in the construction business, sometimes labour charges are made in such manner according to requirement of work. However, assessee’ AR could not furnish any further detail/document to substantiate his reply. Hence, the same is not acceptable. Therefore, amount of Rs.5,00,000/- out of construction labour expenses are disallowed and added back.”*

13. After going through the above findings of the assessing officer, we note that assessing officer has applied his mind on various issues raised by the Id. PCIT in his revision order. It is pertinent to mention here that there was as such no allegation of ‘no enquiry’ or ‘lack of enquiry’ or verification, because the Ld. Pr. C.I.T. himself found all the details/evidences in the assessment record, i.e. well within the assessing



officer's possession and what he alleged was about the plausible view taken by the assessing officer, as against his perception and understanding on the same set of facts and documents. Therefore, the notices issued for examination of the issues during the assessment proceedings and submission and verification of the same has not been shown to be fallacious. In this connection it is pertinent to mention here that the way in which assessment should be finalized falls in the exclusive domain of the Assessing Officer. Section 142(1) speaks of inquiry before assessment and gives immense power to the assessing officer for conducting enquiry. Therefore, the assessing officer (A.O.) u/s 142(1)(ii) & (iii) can ask the assessee almost any information which he thinks necessary for passing assessment and even if Ld. PCIT has such results of enquiries, the resultant order cannot be subjected to revision proceedings. Therefore, the very initiation of proceeding u/s. 263 of the Act by the Ld. Pr. C.I.T. is in violation of the settled position in law. When the conditions precedent for invoking revisional power u/s. 263 of the Act on the facts and in the circumstances of the case are not fulfilled in the case of the assessee, the subsequent action in passing the order u/s. 263 on such invalid proceeding becomes null and void. Therefore, order passed by the assessing officer is neither erroneous nor prejudicial to the interest of the revenue.

14. On the above undisputed facts on record, the matter is already decided by Hon'ble Gujarat High Court in the case of **CIT Vs. Arvind Jewellers [2003] 259 ITR 502 (Guj)** following the ratio of decision of Hon'ble Supreme Court in the case of **Malabar Industrial Co. Ltd. Vs. CIT [2000] 243 ITR 83 (SC)** by holding as under:

*“Held, that the finding of fact by the Tribunal was that the assessee had produced relevant material and offered explanations in pursuance of the notices issued under section 142(1) as well as section 143(2) of the Act and after considering the material and explanations, the Income-tax Officer had come to a definite conclusion. Since the material was there on record and the said material*



*was considered by the Income-tax Officer and a particular view was taken, the mere fact that different view can be taken should not be the basis for an action under section 263 . The order of revision was not justified.”*

15. Reliance is also placed on the following decisions, the ratios of which are totally applicable to the facts of the assessee’s case:

**(1) Smt. Juthika Kar vs. ITO [I.T.A. No.1128/Kol/ 2009, dated 16.5.2012]**

*“8. With the leave and consent of my learned brother, however, I may add a few words to my learned brother’s analysis of Hon’ble Delhi High Court’s judgment in the case of Gee Vee Enterprises (supra). Undoubtedly, as noted by their Lordships in that case, an Assessing Officer cannot remain passive in the face of a return which is apparently in order but calls for further enquiry. In such a case, revision proceedings can indeed be initiated and there seems to be no serious controversy in this respect. The fine point, however, one must bear in mind is the distinction between adequate enquiries not having been conducted and the result of such enquiries not having been dealt with by way of a speaking order or not having resulted in the conclusion that could be, in the wisdom of a person other than the Assessing Officer, more appropriate. Here is a case in which sufficient enquiries were conducted. As learned brother has rightly noted, the Assessing Officer called for specific details, confirmations and even copies of bills. It could not, therefore, be said that sufficient enquiries were not conducted. However, what is opinion formed as a result of these enquiries is something which is in exclusive domain of the Assessing Officer, and even if Commissioner has such results of enquiries, the resultant order cannot be subjected to revision proceedings. The conclusions arrived at as a result of enquiries cannot be tinkered with in the revision proceedings. The conclusions being drawn up as a result of enquiry is a highly subjective exercise and as to what is appropriate conclusion is something on which perceptions vary from person to persons. These variations in the perceptions of the Assessing Officer vis-à-vis that of the Commissioner, cannot render an order erroneous and prejudicial to the interest of the revenue.*

*9. Viewed in this perspective, and having noted that the Commissioner has subjected the assessment order mainly on the ground that the Assessing Officer did not reach the right conclusions as a result of his enquiry, the impugned revision order is indeed unsustainable in law. It is not a case in which adequate enquiries has not been carried out.” [Emphasis given]”*

**(2) CIT vs. J.L. Morrison (India) Ltd. (2014) 366 ITR 593 (Cal)**

*“85. Whether the assessment order dated March 28, 2008, was passed without application of mind is basically a question of fact. The learned Tribunal has held that the assessment order was not passed without application of mind. The records of the assessment including the order-sheets go to show that appropriate enquiry was made*



and the Assessee was heard from time to time. In deciding the question the court has to bear in mind the presumption in law laid down in section 114 clause (e) of the Evidence Act : “that judicial and official acts have been regularly performed.”

86. Therefore, the court has to start with the presumption that the assessment order dated March 28, 2008, was regularly passed. There is evidence to show that the Assessing Officer had required the Assessee to answer 17 questions and to file documents in regard thereto. If the A.O. cannot be shown to have violated any form prescribed for writing an assessment order, it would not be correct to hold that he acted illegally or without applying his mind.” [Emphasis given]

16. Based on the above facts and circumstances, it can be stated that assessing officer made adequate enquiries and conducted necessary examination on the various issues raised by the Id. PCIT. Therefore, it goes to establish that the proceeding u/s. 263 and order passed thereupon was totally uncalled for in the case of the assessee and that being so, the impugned order u/s. 263 of the Act of the Ld. Pr. C.I.T. should be quashed as per law. Accordingly, we quash the order passed by the Ld. PCIT u/s 263 of the Act.

17. In the result, the appeal filed by the assessee is allowed.

**Order is pronounced in the open court on 13/01/2025.**

Sd/-  
**(DINESH MOHAN SINHA)**  
**JUDICIAL MEMBER**

Rajkot

दिनांक/ Date: 13/01/2025

**Copy of the Order forwarded to**

1. The Assessee
2. The Respondent
3. The CIT(A)
4. Pr. CIT
5. DR/AR, ITAT, Rajkot
6. Guard File

Sd/-  
**(Dr. A.L. SAINI)**  
**ACCOUNTANT MEMBER**

By order

Assistant Registrar/Sr. PS/PS  
ITAT, Rajkot