

M/s SriKrishna Security Services  
M/s Sriram Krishna Security Services  
M/s Sriram Maintenance Services  
M/s Sriram Maintenance Services  
M/s Sriram Security Agency  
M/s Sriram Security & Consultancy Services  
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ITA 5671/Mum/2010 &  
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आयकर अपीलिय अधिकरण "एच" न्यायपीठ मुंबई में  
**IN THE INCOME TAX APPELLATE TRIBUNAL  
MUMBAI BENCH "H", MUMBAI**

श्री जेसन पी बोज़, लेखा सदस्य एवं  
श्री अमित शुक्ला, न्यायिक सदस्य के समक्ष ।

**BEFORE SHRI JASON P BOAZ, ACCOUNTANT MEMBER  
AND SHRI AMIT SHUKLA, JUDICIAL MEMBER**

**ITA No. : 5671/Mum/2010**  
(Assessment year: 2001-02)  
**ITA No. : 5672/Mum/2010**  
(Assessment year: 2002-03)  
**ITA No. : 5673/Mum/2010**  
(Assessment year: 2003-04)  
**ITA No. : 5674/Mum/2010**  
(Assessment year: 2004-05)

M/s SriKrishna Security Services Through Ex-partner Mr. Hemendra R Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001 स्थयी लेखा सं.:PAN: <b>AAMFS 7297 K</b>	<b>Vs</b>	ACIT –CC 35, Mumbai
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Nitesh Joshi
Respondent by	:	Shri Rahul Raman

**ITA No. : 4920/Mum/2010**  
(Assessment year: 2001-02)  
**ITA No. : 4921/Mum/2010**  
(Assessment year: 2002-03)  
**ITA No. : 4922/Mum/2010**  
(Assessment year: 2003-04)  
**ITA No. : 4923/Mum/2010**  
(Assessment year: 2004-05)

ACIT –CC 35, Mumbai	<b>Vs</b>	M/s SriKrishna Security Services Through Ex-partner Mr. Hemendra R Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001 स्थयी लेखा सं.:PAN: <b>AAMFS 7297 K</b>
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Rahul Raman
Respondent by	:	Shri Nitesh Joshi

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**ITA No. : 5659/Mum/2010**

(Assessment year: 2001-02)

**ITA No. : 5660/Mum/2010**

(Assessment year: 2002-03)

**ITA No. : 5661/Mum/2010**

(Assessment year: 2003-04)

**ITA No. : 5662/Mum/2010**

(Assessment year: 2004-05)

M/s Sriram Krishna Security Services (Since Dissolved) Through its Ex-partner Mr. Hemendra Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001 स्थयी लेखा सं.:PAN: <b>AAMFS 2023 E</b>	<b>Vs</b>	ACIT –CC 35, Mumbai
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Nitesh Joshi
Respondent by	:	Shri Rahul Raman

**ITA No. : 4938/Mum/2010**

(Assessment year: 2001-02)

**ITA No. : 4939/Mum/2010**

(Assessment year: 2002-03)

**ITA No. : 4940/Mum/2010**

(Assessment year: 2003-04)

**ITA No. : 4941/Mum/2010**

(Assessment year: 2004-05)

ACIT –CC 35, Mumbai	<b>Vs</b>	M/s. Sriram Krishna Security Services (Since Dissolved) Through its Ex- partner Mr. Hemendra Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001 स्थयी लेखा सं.:PAN: <b>AAMFS 2023E</b>
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Rahul Raman
Respondent by	:	Shri Nitesh Joshi

**ITA No. : 5656/Mum/2010**

(Assessment year: 2002-03)

**ITA No. : 5657/Mum/2010**

(Assessment year: 2003-04)

**ITA No. : 5658/Mum/2010**

(Assessment year: 2004-05)

M/s Sriram Maintenance Services Through Ex-partner Mr. Hemendra R Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001	<b>Vs</b>	ACIT –CC 35, Mumbai
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स्थयी लेखा सं.:PAN: <b>AARFS 6445 G</b>		
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Nitesh Joshi
Respondent by	:	Shri Rahul Raman

**ITA No. : 4924/Mum/2010**

(Assessment year: 2002-03)

**ITA No. : 4925/Mum/2010**

(Assessment year: 2003-04)

**ITA No. : 4926/Mum/2010**

(Assessment year: 2004-05)

ACIT –CC 35, Mumbai	<b>Vs</b>	M/s Sriram Maintenance Services Through Ex-partner Mr. Hemendra Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001 स्थयी लेखा सं.:PAN: <b>AARFS 6445 G</b>
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Rahul Raman
Respondent by	:	Shri Nitesh Joshi

**ITA No. : 5663/Mum/2010**

(Assessment year: 2001-02)

**ITA No. : 5664/Mum/2010**

(Assessment year: 2002-03)

**ITA No. : 5665/Mum/2010**

(Assessment year: 2003-04)

**ITA No. : 5666/Mum/2010**

(Assessment year: 2004-05)

M/s Sriram Security Agency Through Ex-partner Mr. Hemendra R Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001 स्थयी लेखा सं.:PAN: <b>AAMFS 7296 J</b>	<b>Vs</b>	ACIT –CC 35, Mumbai
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Nitesh Joshi
Respondent by	:	Shri Rahul Raman

**ITA No. : 4946/Mum/2010**

(Assessment year: 2001-02)

**ITA No. : 4947/Mum/2010**

(Assessment year: 2002-03)

**ITA No. : 4948/Mum/2010**

(Assessment year: 2003-04)

**ITA No. : 4949/Mum/2010**

(Assessment year: 2004-05)

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ACIT –CC 35, Mumbai	<b>Vs</b>	M/s Sriram Security Agency Through Ex-partner Mr. Hemendra R Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001 स्थयी लेखा सं.:PAN: <b>AAMFS 7296 J</b>
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Rahul Raman
Respondent by	:	Shri Nitesh Joshi

**ITA No. : 5667/Mum/2010**

(Assessment year: 2001-02)

**ITA No. : 5668/Mum/2010**

(Assessment year: 2002-03)

**ITA No. : 5669/Mum/2010**

(Assessment year: 2003-04)

**ITA No. : 5670/Mum/2010**

(Assessment year: 2004-05)

M/s Sriram Security & Consultancy Services Through Ex-partner Mr. Hemendra R Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001 स्थयी लेखा सं.:PAN: <b>AAOFS 9271 R</b>	<b>Vs</b>	ACIT –CC 35, Mumbai
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Nitesh Joshi
Respondent by	:	Shri Rahul Raman

**ITA No. : 4934/Mum/2010**

(Assessment year: 2001-02)

**ITA No. : 4935/Mum/2010**

(Assessment year: 2002-03)

**ITA No. : 4936/Mum/2010**

(Assessment year: 2003-04)

**ITA No. : 4937/Mum/2010**

(Assessment year: 2004-05)

ACIT –CC 35, Mumbai	<b>Vs</b>	M/s Sriram Security & Consultancy Services Through its Ex-partner Mr. Hemendra Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001 स्थयी लेखा सं.:PAN: <b>AAOFS 9271 R</b>
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Rahul Raman
Respondent by	:	Shri Nitesh Joshi

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**ITA No. : 5652/Mum/2010**

(Assessment year: 2001-02)

**ITA No. : 5653/Mum/2010**

(Assessment year: 2002-03)

**ITA No. : 5654/Mum/2010**

(Assessment year: 2003-04)

**ITA No. : 5655/Mum/2010**

(Assessment year: 2004-05)

M/s Sriram Warehousing Corporation Through its Ex-partner Mr. Hemendra R Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001 स्थयी लेखा सं.:PAN: <b>AAOFS 8812 N</b>	<b>Vs</b>	ACIT –CC 35, Mumbai
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Nitesh Joshi
Respondent by	:	Shri Rahul Raman

**ITA No. : 4950/Mum/2010**

(Assessment year: 2001-02)

**ITA No. : 4951/Mum/2010**

(Assessment year: 2002-03)

**ITA No. : 4952/Mum/2010**

(Assessment year: 2003-04)

**ITA No. : 4953/Mum/2010**

(Assessment year: 2004-05)

ACIT –CC 35, Mumbai	<b>Vs</b>	M/s Sriram Warehousing Corporation Through its Ex-partner Mr. Hemendra Merchant, 211/219, 2 <sup>nd</sup> Floor, Bharti Bhavan, P'DMello Road, Fort, Mumbai -400 001 स्थयी लेखा सं.:PAN: <b>AAOFS 8812 N</b>
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant by	:	Shri Rahul Raman
Respondent by	:	Shri Nitesh Joshi

सुनवाई की तारीख /Date of Hearing : 08-12-2015

घोषणा की तारीख /Date of Pronouncement : 16-12-2015

आदेश

**ORDER**

**PER BENCH:**

The aforesaid cross appeals filed by the aforesaid assessees as well as by the revenue in the case of the aforementioned assessees have been filed against separate impugned orders of even date, 30.03.2010, passed by the CIT(A)-41, Mumbai for the quantum of assessment passed u/s 143(3) r.w.s. 153A for the assessment years 2001-02, 2002-03, 2003-04 and 2004-05.

2. At the outset all the appeals filed by the assessees hereinabove, are time barred by 34 days. In the petition for condonation of delay, which is accompanied by an averment made on oath in affidavit, it has been stated that, due to serious health problems and hospitalization of Mrs. Hema H. Merchant, one of the erstwhile partner and wife of Shri Hemendra Merchant, the appeal could not be filed in time. After hearing the Ld. Counsel, and material placed on record we are convinced that there was a reasonable cause in not filling the appeal on time and accordingly, we condone the delay of 34 days and take the appeal to be decided on merits.

3. Since the issues involved in all the appeals are common arising out of identical set of facts, therefore, same were heard clubbed together and are being disposed off by way of this consolidated order for the sake of convenience & brevity.

4. In all the appeals of the assessees, the grounds raised are identically worded, therefore, for the sake of ready reference, the grounds raised in ITA No. 5671/Mum/2010 in the case of M/s SriKrishna Security Services for the assessment year 2001-02 is being reproduced herein below:-

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- “1. *The CIT(A) erred in holding that the validity of the search and seizure operation cannot be challenged in appeal proceedings before the CIT(A) or the Tribunal.*
2. *That independent of the issue of whether validity of the search and seizure operation can be challenged in appeal proceedings, the CIT(A) ought to have held that validity of the assessment proceedings can be raised in appeal proceedings.*
3. *The CIT(A) ought to have held that the proceeding taken by the AO under section 153A of the Act without fulfilling the jurisdictional pre-conditions in that section is illegal and bad in law.*
4. *The CIT(A) erred in holding that in the present case assessment proceedings can be carried out in the hands of the appellant (i.e. a dissolved firm) even though Mr. Hemendra Merchant (partner of the said dissolved firm) has filed an application before Income Tax Settlement Commission (ITSC).*
5. *The CIT(A) erred in not computing the income of the Appellant on the basis of books of account regularly maintained by it.*
6. *The CIT(A) erred in estimating the Appellant’s income on the basis of comparable without appreciating that its case did not fall within the provision of section 145(3) of the Act.*
7. *The CIT(A) erred in estimating the net profit of the Appellant at the rate of 10% of the Gross Receipts.*
8. *The CIT(A) ought to have held that the appellant is entitled to deduction in respect of administrative expenses.*
9. *The CIT(A) ought to have allowed deduction in respect of remuneration to partners as claimed in the Return of Income”.*

5. Similarly, in all the appeals of the Revenues, the grounds raised are identically worded, therefore, for the sake of ready reference, the grounds raised in ITA No. 4920/Mum/2010 in the case of M/s SriKrishna Security Services for the assessment year 2001-02 is being reproduced herein below:-

- “1. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in reducing the net profit @ 10% from 70% estimated by the AO.*

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2. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) failed to appreciate the basis of estimating net profit @ 70% and comparison with other entities was not required.*
3. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) failed to appreciate the fact that the source of investments in Fixed Deposits/bonds was mainly generated from the unaccounted income of the firm”.*

6. Facts in brief are that, the assessee was a partnership firm consisting of Shri Hemendra R Merchant and Smt. Hema H. Merchant. All these partnership firms were constituted by these two partners. These firms were dissolved on 31<sup>st</sup> March, 2004 and the business was continued by Shri Hemendra R Merchant in his individual capacity. The firm was engaged in the business of providing Security Guards /Security services to various entities including public sector undertakings, banks etc. A search and seizure action u/s 132(1) was carried out on the premises of Shri Hemendra R Merchant on 21.12.2006. Even though the assessee firm was dissolved and was not in existence at the time of search, notices u/s 153A were issued on 28.03.2007 in pursuance of search and seizure action u/s 132(1), for filing of the returns of income right from assessment years 2001-02 to 2004-05. As noted by the AO in the assessment order, during the course of search and seizure operation and post search enquiries, it was found that Mr. Hemendra R Merchant was a key person of the Group and records for business were not properly maintained, especially in respect of the expenditures incurred on account of security charges which were in fact, found to be highly inflated so as to understate the net profit from the business. This inflation of expenses has generated into unaccounted income which was invested in the form of Bank FDRs, Bonds, NSCs, etc., in the name of Mr. Hemendra Merchant and Mrs. Hema H. Merchant, either individually or jointly or in the name Hemaben and Hemendra

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Merchant's Trust. It has further been mentioned in the impugned assessment orders that Mr. Hemendra Merchant, vide letter dated 13.02.2007 stated that, out of total investments found, investments worth Rs.5,12,23,284/- were not disclosed in the returns of income filed and accordingly, he offered to pay the tax and interest on such undisclosed investments. The AO in his detailed assessment order for all the assessment years has ultimately held that the net profit from the business of security services should be estimated @ 70% of the gross receipts. The reasons for estimating such a huge net profit were that:-

*i) Firstly*, the assessee could not furnish the books of accounts including bank statements, bills and vouchers etc. in support of the statements of the audited accounts filed along with the return of income. The assessee's case before the AO in this regard was that, its books of accounts were seized during the course of search conducted by Service Tax Department (Excise and Customs) & Provident Fund Departments. However, the AO rejected the assessee's contention on the ground that, Panchnama of these searches does not reveal that original books of accounts were seized. Thus, he observed that, there is no option but to assess the total income of the assessee on estimate basis;

*ii) Secondly*, the basis for adopting 70% rate was that, during the course of search, certain details contained in pages no. 27 to 43 of Annexure-A-2 to Panchnama dated 21.12.2006 found and prepared in respect of search in the residence of Mr. Hemendra R Merchant, revealed certain details of security charges received for the period 1<sup>st</sup> April, 2004 to 31<sup>st</sup> December, 2004 which were quantified at Rs. 1,29,63,498/- and as against this receipt, security charges paid for the relevant period both in respect of

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guards hired on own and the guards outsourced by outside agencies was Rs. 28,50,996/-. From this he inferred that, the security charges paid works out to only 22% of the receipts. This inference as observed by the AO is also corroborated by the huge amounts shown against sundry creditors appearing in the Balance sheet for the year after year. The details of which have been noted by him at page 7 of the assessment order, which for the sake of the ready reference are enumerated hereunder:-

<b>A.Y.</b>	<b>Gross Receipts</b>	<b>S/C as at the year end</b>
2001-02	Rs. 19,98,548/-	Rs. 11,39,769/-
2002-03	Rs. 6,99,652/-	Rs. 10,10,292/-
2003-04	Rs. 2,57,286/-	Rs. 9,93,484/-
2004-05	Rs. 1,06,300/-	Rs. 10,03,984/-

Thus, he observed that, the figures of sundry creditors were disproportionately high as compared to the level of operations carried on by the assessee. This goes to show that assessee had earned huge net profit during these years.

iii) *Third* reason given by him was that, during the course of search at the residence of Mr. Hemendra Merchant, it was found that certain payments were made by the Group Concerns to M/s Usha Security Services by cheques on various dates and the same were returned by this concern in cash after retaining minor portion of such payments which obviously he inferred were trade commission for arranging the accommodative transactions.

7. The AO though admitted that all these facts which were gathered during the course of search, pertained to certain relevant period only, however, they highlight the *modus operandi* adopted by the assessee firms and other group concerns for inflating the expenses under the head "Security charges" which ultimately leads to high profit which in turn have been applied towards unaccounted investment in FDRs, Bonds etc. Thus, he concluded

that the crucial corroborating factor in support of such a high estimate of business income @ 70% of the gross receipts is from unaccounted investments in FDRs and Bonds. Based on these detailed analysis, he applied the net profit rate of 70% of the gross receipts in assessments of all the firms in all the impugned assessment years.

8. Before the First Appellate Authority, the assessee-firm filed detailed submissions along with various documents to rebut the various findings as given by the AO. All these submissions and details were forwarded to the AO for submission of his remand report. The assessee's contention as well as relevant content of the remand report of the AO have been discussed and incorporated by the CIT(A) in the impugned appellate order. The sum and substance of the AO's finding; assessee's rebuttal; and his finding has been dealt by the CIT(A) in para 3.26, which are summarized as under:-

- (a) With respect to the AO's finding that Mr. Merchant had earned profit of 78% of the gross receipts based on documents found relating to the period 01.04.2004 to 31.12.2004, CIT(A) has held that the same represented incomplete data in which major entries including those appearing in the bank statement were not entered into. Even complete data for that period was available in the course of search of which the backup had been taken by the Income-tax Department. Further, he has found the said information to be irrelevant for the present assesseees because, they relate to a separate assessee (i.e., Mr. Hemendra Merchant as sole

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proprietor of business) and for a period which is after the dissolution of the Assessee firms on 31.03.2004.

- (b) With respect to the AO's finding that there is a disproportionate increase in the sundry creditors in comparison to the gross receipts, CIT(A) held that there is no such increase and in case there is any increase it is relatable to payments to security guards which had been withheld by the assessee in those cases where there was a loss by theft to the person to whom guarding services were rendered. He also held that the AO has failed to point out that any creditor is bogus in the present case.
- (c) With respect to the AO's finding that payments were made by cheque to Usha Security Services which were returned back by them in cash, CIT(A) held that the said entries pertain to the period after the dissolution of the assessee firms. Further, the said document has been found by him to be irrelevant in the present cases as the same relates to assessment year 2005-06 i.e., after the dissolution of the assessee firms on 31.03.2004.
- (d) With respect to the alleged undisclosed investments as found in the hands of Mr. Merchant, Mrs. Merchant and Hemaben and Hemendra Merchant's Trust, CIT(A) has held that the said investments are not in the name of the Assessee firms. The Assessee firms have also have not claimed ownership of the said investments. Further, the FDRs are not prior to 01.04.2004 i.e.,

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when the assessee firms were dissolved. In view thereof, he has concluded that no adverse inference could be drawn in the assessee's case with respect to the said investments.

- (e) However, Ld. CIT(A) held that the rejection of books of account by the AO on the ground that the assessee was unable to produce its books of account and vouchers in the course of assessment proceedings is to be upheld. He also accepted that there was a default on the part of the assessee firms to produce books of account, even though he noted that they did not had the said books and information due to seizure of books during the course of search and seizure action undertaken by the Service Tax Department on 02.03.2004 and the Provident Fund Department on 01.03.2007.

9. Thus, on the issue of investment made in various FDRs, NSCs, RBI bonds etc. in the name of Shri Hemendra R Merchant and Smt. Hema H Merchant, and Hemaben and Hemendra Merchant's Trust, the Ld. CIT(A) concluded that admittedly, no investment have been found during the search and seizure operation in the name of the firms and hence no adverse inference or addition can be made in the hands of the firm *qua* FDRs etc. He also held that since assessee could not produce the books of accounts and was not in possession of vouchers etc., therefore, there is no option or recourse left, except for making best judgment assessment. He further noted that, the assessee had submitted the Tax Audit report u/s 44AB along with the return of income much prior to the date of search and such an Audit report also qualifies the expenditures incurred by the assessee. Further, the return of

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income in some of the years have been accepted by the Department u/s 143(3), wherein, the net profit rate shown was around 4% to 8%. After discussing all the above facts and circumstances, he proceeded to arrive at reasonable net profit rate. For this purpose he took note of three comparable cases engaged in a similar business of security services so as to benchmark the net profit margins of these firms with the assessee so as to arrive at the reasonable net profit margin for estimating the assessee's income. The details of these comparables have been given at page 31 of the impugned order. Apart from that, he further noted the past history of the assessee-firm in various years which has been noted at page 32 of the appellate order in the following manner:-

	<b>AY 2001-02 Net Profit</b>	<b>AY 2002-03 Net Profit</b>	<b>AY 2003-04 Net Profit</b>	<b>AY 2004-05 Net Profit</b>
Sriram Warehousing Corporation	4%	4%	4%	6%
Sri Ram Krishna Securities Services	10%	9%	6%	8%
Sri Ram Security & Consultancy	4%	3%	4%	7%
Sri Ram Security Agency	8%	8%	6%	16%
Sri Krishna Security Services	9%	9%	Loss	Loss
Sri Ram Maintenance Services	No return	5%	6%	9%

10. After considering the profit margins of the comparable cases and assessee's past history, he held that the net profit rate should be taken at 10%. Now against this, both the assessees as well as revenue have come in appeal before us.

11. Before us, Ld. Counsel for the assessee, Mr. Nitesh Joshi Ld. Counsel first of all raised the issue of validity of search and seizure operation on the ground that, the assessee firm was not in existence at the time of search, therefore, there could not have been any valid 'reasons' for issuing warrant in the name of the assessee firms. He also informed us that the issue of validity of

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search was challenged by way of Writ jurisdiction before the Hon'ble Bombay High Court, wherein, the Hon'ble High Court had rejected the assessee's petition. Against the said judgment of the Hon'ble High Court, the assessee preferred a SLP before the Hon'ble apex court and the Hon'ble Supreme Court set aside the order of the High Court, and held that the Tribunal will adjudicate and decide the issue relating to validity of search. Therefore, he strongly contended that the issue of validity of the search should be addressed first. On the issue of application of net profit rate, Mr. Joshi after narrating the entire facts and the contentions raised by the assessee before the CIT(A) to rebut the finding of the AO, submitted that there is no valid reason for estimating the net profit rate @ 10%, when the assessee's net profit rate all throughout has been much below 10% and in this year it is 4% which should be accepted. He submitted that now the only reason for applying the net profit rate and rejecting the books of accounts is that, the assessee could not produce the books of account. In this regard it is undisputed fact that assessee's books of accounts were seized by the Service Tax Department and Provident Fund Department and therefore the audited accounts which were prepared on the basis of books of accounts is a relevant material to accept the assessee's income. As an alternative plea, he submitted that in case net profit rate of 10% is to be applied, then interest and remuneration paid to the partners should be allowed. Such an allowance of interest and remuneration to the partners has been provided in the section 44AD itself. This provision itself is guidance for allowing such an interest when net profit rate is estimated. Further, in support of this contention, he strongly placed reliance on the decision of Rajasthan High Court in the case of CIT v Jain Construction Company, reported in 245 ITR 527 (Raj.) and CIT vs Supreme Builders, reported in 303 ITR 1 (P&H). In these cases, the

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Hon'ble High Courts have held that, in cases of estimation of income after rejection of books of accounts, the assessee would be entitled to deduction of remuneration and interest paid to the partners in accordance with section 40(b).

12. On the other hand, Ld. CIT DR, submitted that, here in this case, the determination of net profit rate of 70% is not merely an estimate *albeit* is based on various documentary evidences found at the time of search. He referred to the relevant paragraphs of the AO wherein, he has given justification for application of net profit rate of 70%, which according to him was mainly on account of details of receipts and expenditure found for the period 01.04.2004 to 31.12.2004 as noted by the AO. Besides this, in this case, it is an admitted fact that huge investment made in FDRs, NSCs out of unaccounted income were made. This is further corroborated by huge amounts mentioned under the head "sundry creditors". Thus, without any proper verification and without producing books of accounts or details either during the course of assessment proceedings or appellate proceedings, the trading result and the net profit shown by the assessee cannot be accepted. He submitted that Mr. Hemendra Merchant was key person who was managing the affairs of the firm and after dissolution the same work was continued by him. Therefore, the *modus operandi* and the records found for the subsequent period will provide vital information for drawing the inference for the years in which the assessee-firms were doing business. Thus, he submitted that, the net profit rate as applied by the AO is fully justified on the facts and material on records, which has been gathered not during the course of assessment proceedings but in the course of search. He further tried to link the undisclosed income surrendered by Mr. Hemendra Merchant and estimation of net profit rate of 70% by contending

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that, such an investment could have been made only when assessee had huge amount of undisclosed income from security services. This itself goes to show that, the huge income must have been earned by the assessee on the gross receipts. Thus, he strongly relied upon the order of the AO. On the issue of comparables, he submitted that, one of the comparable chosen by the assessee, i.e. Usha Security Services, it has been found that this party was *conduit* in giving accommodation entry to the assessee and, therefore, such a comparable case given by the assessee cannot be used for benchmarking the margin. Thus, the comparable cases provided by the assessee for arriving at net profit rate of 10% cannot be accepted.

13. We have carefully considered the rival contentions and perused the relevant findings given in the impugned orders. It is an admitted fact that, at the time of search and seizure action on 21.12.2006, all these partnership firms stood dissolved way back on 31.03.2004 and were no longer in existence. All the materials which have been found during the course of search and post search enquiries as referred to by the AO do not pertain to the assessee-firm but to Mr. Hemendra Merchant. Here in this case, the main issue is, whether AO is justified in rejecting the books of accounts and applying the net profit rate of 70%. The CIT(A) though has upheld the rejection of books of accounts but has confirmed the net profit rate of 10%, against which both are in appeal. The revenue's case had been that, the application of net profit of 70% is based on materials found during the course of search in the form of certain seized annexures giving the details of security charges received and expenditure incurred for the period of 9 months starting from 01.04.2004 to 31.12.2004. Admittedly in this period, the assessee firm was not in existence, therefore, this

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material may not be much of relevance for drawing adverse inference against the assessee-firm. The *second* reason given by the AO for applying such a high net profit rate is that, during the course of search, huge unaccounted investments were found in the name of partners in an individual capacity, which goes to show that these investments were made from unaccounted money generated by inflating the expenses and surpassing the net profit rate. This reason also cannot be taken in to account for estimating such an astronomical net profit rate, *firstly*, because this issue is *sub judice* in the case of Hemendra Merchant in individual assessment before the AO; and *secondly*, unaccounted investment in the name of the Hemendra Merchant cannot be attributed to the assessee firm, because no documents whatsoever has been found during the tenure in which the assessee firm were doing their business; *thirdly*, one of the ground raised by the AO that certain payments were made by cheque to M/s Usha Security Services which has returned back to them in cash is also not tenable here because this information too does not pertained to assessee-firm and further such an alleged accommodation entry was not for the period when these firms were conducting business, hence, all these information and material found for the posterior period of dissolution of the firm cannot be adversely viewed for estimating such a huge net profit rate. *Lastly*, the AO's reason that the books of accounts were not produced either before the AO or before the CIT(A) to which the Ld. Counsel had submitted that, these were seized by Service Tax Department and Provident Fund Department during the course of search conducted earlier hence they could not be produced. In support, a copy of Panchnama has been filed which is placed in the paper book. Thus, all these factors materially do not justify the estimation of such a huge net profit rate for assessing the income of the assessee firms. The Ld. CIT(A)

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has given very detailed finding to controvert the observation and the finding of the AO for estimating a huge net profit of 70%, which we affirmed for the reasons given above. Accordingly, the finding of the CIT(A) to the extent that such a huge net profit rate cannot be applied, is affirmed by us.

14. However, the main issue remains, whether under the given facts and circumstances of the case, the book results as shown by the assessee which has been reflected in the form of audited statement of accounts can be accepted or not. The assessee has shown net profit rate of 4% during the year. Such a net profit rate has not been substantiated by any documentary evidences or the entries in the regular books of accounts, then principally, we agree with the Ld. CIT(A) that the book results for these assessment years and net profit shown by the assessee cannot be accepted as such and best judgment assessment has to be made for arriving at the reasonable net profit based on assessee's own past history or comparable cases. As noted above, in the case of assessee-firm for various assessment years, net profit rate has ranged from 4% to 9%. The three comparable cases also have shown the net profit rate of around 7% to 8%. After taking note of these comparable cases and past history of the assessee, the rate of 10% of net profit on the gross receipt as applied by the CIT(A) appears to be quite reasonable and justifiable. It has been further brought on record by the Ld. Counsel at the time of hearing that, in the assessment year 2008-09 and 2009-10 in the cases of Mr. Hemendra Merchant, the net profit rate of 10% has been applied by the AO which stands accepted. Thus, we affirm the conclusion of the CIT(A) so far as the application of net profit rate of 10% for estimating the income of the assessee. Accordingly, we direct the

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AO to apply net profit rate of 10% in all the cases for the assessment years impugned before us.

15. Now coming to the issue of allowing of remuneration and interest paid to the partners in accordance with section 40(b). We agree with the contention of Ld. Counsel that, if a net profit rate is being applied for estimating the income of the partnership firm, then such an interest and remuneration has to be allowed, because it is an outgoing from net profit derived by the partnership firm. Such an allowance is also fully supported by the decision of Hon'ble Rajasthan and P&H High Courts, as referred by the Ld. Counsel. So, accordingly, we direct the AO to allow interest and remuneration paid to the partners from the net profit of 10%. Thus, on this score, the assessee's grounds are treated as partly allowed.

16. So far as issue relating to validity of search, the same is treated as academic solely for the reason that, on merits the assessee has got substantial relief. Accordingly, the issue of validity of search is left open. Accordingly, the appeal of the assessee is treated as partly allowed.

17. So far as grounds raised by the revenue, the same is treated as dismissed in view of the finding given above that, net profit rate of 10% is to be applied which has been affirmed by us while deciding the assessee's appeal. Accordingly, the grounds raised in all the revenues appeals are dismissed.

18. Since in all the appeals the issue involved are identical, therefore, the finding given above will apply *mutatis mutandis* in all the appeals and accordingly all the appeals filed by the assessee

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are treated as partly allowed whereas, the revenue's appeal are treated as dismissed.

Order pronounced in the open court on 16<sup>th</sup> December, 2015.

**Sd/-**  
(जेसन पी बोझ)  
लेखा सदस्य  
**(JASON P BOAZ)**  
**ACCOUNTANT MEMBER**

**Sd/-**  
(अमित शुक्ला)  
न्याईक सदस्य  
**(AMIT SHUKLA)**  
**JUDICIAL MEMBER**

**Mumbai, Date: 16<sup>th</sup> December, 2015**

प्रति/Copy to:-

- 1) अपीलार्थी /The Appellant.
  - 2) प्रत्यर्थी /The Respondent.
  - 3) The CIT(A) -41, Mumbai.
  - 4) The CIT-Central III, Mumbai.
  - 5) विभागीय प्रतिनिधि "एच", आयकर अपीलीय अधिकरण, मुंबई/  
The D.R. "H" Bench, Mumbai.
  - 6) गार्ड फाईल \
- Copy to Guard File.

आदेशानुसार/By Order

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I.T.A.T., Mumbai

\*चव्हान व.नि.स

\*Chavan, Sr.PS