



REJECTION OF BOOKS OF ACCOUNTS BY ASSESSING OFFICERS: A LEGAL PERSPECTIVE

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Assessing officers arbitrarily reject books of accounts without invoking provisions of section 145(3) of the Income Tax Act 1961 in a real spirit of law and arbitrarily mention section 145(3) of the Income Tax Act 1961 for application of net profit rate on the turnover posted by the assessee. The assessing officer has to work out and deliberate a detailed exercise and pointing out all such reason and defects due to which the assessing officer is unable to rely on the books of accounts maintained and accordingly to deduce actual net profit earned by the assessee, instead without doing such a detailed exercise and without pointing out such defects the assessing officers apply net profit rate arbitrarily. Even if some defects are pointed out but such defects too are arbitrarily and does not suit the true test and requirements of section of 145(3) of the Income Tax Act 1961. This is well deliberated by The Honorable bench of ITAT, third Member Bench in the matter of Raja & Co Vs Assessing officer ward Baramulla. The Honorable bench has held rejection of books of accounts not justified as the reasons recorded for rejection of such books of accounts are not meeting the criteria as laid down in section 145(3) of the Income Tax Act 1961. The descent between the members of the regular bench of Honorable Bench of ITAT, Amritsar Bench whether the rejection of books of accounts of the assessee are justified or not. The Question of law before Honorable third Member of the Amritsar Bench was whether the assessing officer is justified in rejection of books of accounts. Within the framework of law the A.O may proceed under Section 145(3) under any of the following circumstances:

- a) Where assessing officer is not satisfied about the correctness or completeness of the accounts; or
- b) Where method of accounting cash or mercantile has not been regularly followed by the assessee ; or
- c) Accounting Standards as notified by the Central Government have not been regularly followed by the assessee.

Though the broad parameters have been laid down in the Section itself under which the provisions are required to be invoked for rejection of books of account in a particular case, yet, a definite ground work is *sine-quantum* on part of the Assessing Officer before resorting to the provisions of section 145(3) of the Income Tax Act 1961.

It is noted that in a large number of cases the provisions of Section 145(3) of the Income Tax Act 1961 are invoked on the pretext of fall in gross profit rate. Though the fall in G.P rate definitely provides a ground to the Assessing Officer for invocation of the provisions of Section 145(3) yet it is not a sufficient condition. The Assessing Officer is required to analyse various other parameters which have the effect on the gross profit rate of the assessee for the relevant period, before drawing any conclusion on the merit of such claim. The fall in G.P rate might be a symptom of malice with which the assessee's account would be suffering. However, it is the duty of the Assessing Officer to pin point the malice and bring it out in the Assessment order. In the case of low gross profit rate, there could be inflated purchases or unrecorded sales besides manipulation in the valuation of closing stock. Therefore, the Courts expect that the Assessing Officer shall bring on record specific defects in the books of account of the assessee before invoking the provisions of Section 145(3). The rejections of books of account simply on lower G.P rate in comparison to earlier years or with other assessee's placed in similar circumstances would not suffice and will not stand the test of appeal. The Power vested with the assessing officer U\S 145(3) has to be exercised judiciously not arbitrarily. When the Assessing Officer does not accept the assessee's method of accounting then he has to resort to the provisions of Section 145(3) for computation of income by adopting such other basis as determined by him. The Karnataka High Court in the case of Karnataka State Forest Industries Corporation Ltd., Vs. CIT (1993) 201 ITR 674 has held that the Assessing Officer's powers under the Section are not arbitrary and he must exercise his discretion and judgment judicially. A clear finding is necessary before invoking the Section 145(3) of the Act. Hon'ble Supreme Court and the various High Courts in number of cases have held that before invoking the provisions of Section 145(3) of the Act [earlier Sections 145(1) and 145(2)]. The Assessing Officer has to bring on record material on the basis of which he has arrived at the conclusion with regard to correctness or completeness of the accounts of the assessee or the method of accounting employed by it.

It is difficult to catalogue the various types of defects in the account books of an assessee which may render rejection of account books on the ground that the accounts are not complete or correct from which the correct profit cannot be deduced. Whether presence or absence of stock register or cash memos in a given situation may not per se lead to an inference that accounts are false or incomplete. However, where a stock register, cash memos, etc., coupled with other factors like vouchers in support of the expenses and purchases made are not forthcoming and the profits are low, it may give rise to a legitimate inference that all is not well with the books and the same cannot be relied upon to assess the income, profits or gains of an assessee. In such a situation the authorities would be justified to reject the account books under section 145(2) and to make the assessment in the manner contemplated in these provisions. This rejection of books of accounts and application of net profit rate under this situation is subject to the fact that assessing officer brings material on record the order speaks about all such plausible defects and accordingly the rejection is justified. In absence of any such exercise and reasons the rejection can be held justified as is well deliberated by third Member Bench of Honorable Bench of ITAT, Amritsar bench in the matter of Raja & Co Vs. Assessing officer Ward Baramulla, Kashmir.

The assessing officers usually after Rejection of Books of Account under Section 145(3) conduct Assessment in the manner under Section 144 of the Income Tax Act 1961. In a case where the provisions of Section 145(3) are attracted, although the assessment is made in the manner provided under Section 144, nevertheless the assessment is made under Section 143(3) of the Act. A clear cut distinction between Best Judgement Assessment and in the manner provided under Section 144 is required to be understood while resorting to the provision of Section 145(3). Under Section 145(3) the assessment is required to be made in the manner under Section 144 of the Act only. However, it is well known fact that in the case of Best Judgement where resort is taken to Section 144, the Assessing Officer exercising his jurisdiction cannot act arbitrarily or capriciously. The assessing officer must proceed on judicial considerations in the light of relevant material that may be brought on record. The Hon'ble Allahabad High Court in the case of CIT V/s. Surjeet Singh Mahesh Kumar (1994) 210 ITR 83 has held that in every case of Best Judgement, the element of guess work cannot be eliminated so long as best judgement has a nexus with material on record and discretion in that behalf has not been exercised arbitrarily or capriciously.

It is seen in most of the assessments made by the assessing officers the orders are quite non speaking while invoking provisions of section 145(3) of the Income Tax Act 1961. From the detailed analysis of section 145(3) of the Income Tax Act 1961 and various judicial pronouncements it is quite binding on the assessing officer to come up with a proper material and bring that on record on which the order itself speaks then the rejection of books of accounts is justified and can apply net profit rate on the basis of comparable cases, industry norm and other relevant factors. Once the books of account of assessee are rejected, then, profit has to be estimated on the basis of proper material available. Nevertheless, the AO is not entitled to make a pure guess and make an assessment with reference to any evidence or any material at all. There must be something more than mere suspicion to support an assessment under Section 143(3) of the Act. The rule of law on this subject has been fairly and rightly stated by the Supreme Court in the case of Dhakeswari Cotton Mills Ltd., v/s. CIT (1954) 26 ITR 775.

Further the assessing officer must not forget to consider the assessment history of the assessee by making elaborate note of it and to defend his contention in comparison with the past assessment history of the assessee. Moreover rejection of accounts in earlier year(s) cannot justify rejection for the current year and the assessment of the current year cannot stand on the pillars of any previous year. It is a well settled position of law that while making the assessment, the account books for that year have alone to be considered, as each assessment year is independent. There is no scope of presumption that merely because for some reason the account books in earlier years were rejected, these stood condemned forever. In this regard the decision of Allahabad High Court in the case of Ram Avtar Ashok Kumar v/s. CST (1980) 45 STC 366 (All) is quite relevant.

To summarize the issue on the basis of above legal perspective the assessing officer can not arbitrarily reject books of accounts, make best judgment assessment and apply a net profit rate without justifying by way of a speaking order and supporting it with material on record that the books of accounts maintained by the assessee are liable to be rejected.