

**IN THE INCOME TAX APPELLATE TRIBUNAL  
'SMC' BENCH, BANGALORE**

**BEFORE SHRI WASEEM AHMED, ACCOUNTANT MEMBER AND  
SHRI SOUNDARARAJAN K, JUDICIAL MEMBER**

ITA No.760/Bang/2026
Assessment Year: 2022-23

Suman Sharma, Prop : Sri Shyam Timbers, No.3, 6 <sup>th</sup> Cross, East Road, Opp. SRS Travels, NTY Layout, Bengaluru – 560 026.  <b>PAN – DZKPS 1431 R</b>	Vs.	The Income Tax Officer, Ward – 2(2)(1), Bengaluru.
APPELLANT		RESPONDENT

Assessee by	:	Shri Subrahmanyam, Advocate
Revenue by	:	Shri Ganesh R Ghale, Standing Counsel for assessee

Date of hearing	:	28.04.2026
Date of Pronouncement	:	08.05.2026

**ORDER**

**PER WASEEM AHMED, ACCOUNTANT MEMBER:**

The present appeal filed at the instance of the assessee is directed against the order of the Learned Commissioner of Income Tax Appeal [hereafter the Learned CIT(A)] under section 250 of the Income Tax Act, 1961 (hereafter the Act) pertaining to Assessment Year 2022-23.

2. The assessee has raised several grounds of appeal which we for sake of brevity and convenience not inclined to reproduce here.

3. The Ground No. 1 of the assessee's appeal is general in nature and does not require any specific/ independent adjudication. Hence, the same is dismissed as infructuous.

4. The issue raised by the assessee through Ground No. 2 of the appeal is that the learned CIT(A) erred in confirming the ad-hoc disallowances of business expenses of Rs. 21,39,441/- only.

5. The facts in brief are that the assessee, an individual, is proprietor of M/s Sri Shayam Timbers. The case of the assessee was selected for scrutiny under CASS on low income. During the assessment proceedings, the AO noted that turnover of the assessee for the year under consideration increased by 91.73% i.e. turnover increased from Rs. 1,55,96,439/- to 2,99,03,132/- in the year under consideration. However, the net profit ratio decreased from 3.13% in F.Y. 2020-21 to 1.94% in the year under consideration. The AO also noted that the assessee in the Profit and Loss account has debited expenses such as Freight Inward, Unloading charges and Petrol expense of Rs. 10,30,000/-, Rs. 1,09,000/- and Rs. 38,500/- but no such expenses were incurred/ claimed in the previous financial year. Likewise, expenses such as conveyance and freight outward increased from 429% & 657% as compared to previous financial year.

6. The assessee explained that due to competition, she started free delivery services to the customer which resulted in increased freight outward and loading/ unloading expenses and her business also increased. The assessee submitted that the observation that there were no freight inward expenses in previous financial year is factually wrong

as such there was freight inward expenses of Rs. 4.7 lakh in the previous year. The assessee further submitted conveyance expenses also increased during the year as she started sending her employees for collection of dues from the sundry debtors/customers. The assessee contended that it is not necessary that expenses incurred over different financial year shall be in same proportion. It was claimed that she has maintained proper books of account and income offered as per books of account which were supported by documents in the form of bills and vouchers.

6.1 However, the AO found that voucher furnished by the assessee are internal vouchers. Further, the vouchers maintained for the freight outward did not contain vehicle details and signature of the receiver. Likewise for petrol expenses voucher maintained for different months (April to December) has uniform amount of Rs. 3500/-. Accordingly, the AO held that expenses claimed by the assessee is not free from doubt. Thus, the AO to cover any leakage of revenue increased net profit by 1% of turnover and thereby made addition of Rs. 2,99,031/- to the business income of the assessee.

7. The aggrieved assessee preferred an appeal before the learned CIT(A). However, the learned CIT(A) confirmed the addition made by the AO by observing as under:

*6. Decision:*

*I have carefully considered the assessment order, grounds of appeal, written submissions, and documents placed on record. The appellant is engaged in the business of trading in timber under the proprietorship concern "Sri Shyam Timbers." The case was selected for scrutiny owing to low income vis-à-vis substantial TCS based turnover. The assessee declared a net profit rate of 1.94% during the year, as against 3.13% in the preceding year, despite a sharp increase in turnover.*

*6.1 The Assessing Officer issued detailed notices u/s 142(1) of the Act calling for supporting evidence of major expenses such as freight inward/outward, unloading, conveyance, and petrol. The AO has recorded in the order that many vouchers were self-made, unsigned, and did not contain essential particulars such as vehicle numbers or acknowledgement of payment. The petrol expenses were recorded through uniform, repetitive self-generated entries, which were unverifiable. No stock reconciliation or reliable explanation was furnished for the sharp fall in net profit rate. The appellant has not rebutted these factual findings during the appellate proceedings. In view of the defects in books and unverifiable nature of expenses, the enhancement of net profit by 1%, resulting in addition of Rs.2,99,031/-, is reasonable and does not call for interference.*

8. Being aggrieved by the order of the learned CIT(A) the assessee is in appeal before us.

9. The learned AR before us submitted that the addition made by the AO and sustained by the learned CIT(A) is unsustainable in law and on facts. It was argued that the assessee maintained regular books of account supported by bills and vouchers, which were duly produced before the AO, and no defects warranting rejection of books were recorded. In absence of rejection of books, estimation of income on an ad-hoc basis is impermissible. The AR explained that the fall in net profit ratio was due to commercial reasons, including increased competition and introduction of free delivery services, leading to higher freight and related expenses. It was further submitted that certain observations of the AO, such as absence of freight inward expenses in the earlier year, were factually incorrect. The Id. AR contended that use of self-made vouchers in small businesses is common and does not render expenses non-genuine without specific defects. Accordingly, deletion of the addition was prayed.

10. Per Contra, the learned DR before us relied on the orders of the AO and the learned CIT(A) and submitted that the addition was justified

in view of deficiencies in supporting evidence. It was argued that several expenses claimed by the assessee were supported only by self-made vouchers lacking essential details such as vehicle numbers and acknowledgements, making independent verification impossible. The Id. DR emphasized that the assessee reported a sharp decline in net profit ratio despite substantial growth in turnover, which raises serious doubts regarding correctness of declared income. In these circumstances, the AO was justified in drawing adverse inference and estimating income to safeguard revenue. The enhancement of net profit by 1% was argued to be reasonable and based on surrounding facts. The DR thus supported the findings of the CIT(A) and prayed for dismissal of the appeal.

11. We have heard the rival contentions of both the parties and perused the materials available on record. The issue for our consideration is whether the action of the AO in enhancing the net profit by 1% on an ad-hoc basis, and the confirmation of the same by the Ld. CIT(A), is justified in the facts and circumstances of the present case.

At the outset, we note that the assessee is engaged in the business of timber trading and has maintained regular books of account which were produced before the AO. It is an admitted position that the AO has not rejected the books of account. In our considered view, this aspect is very crucial. Once the books of account are not rejected by invoking the applicable provisions of the Act, the AO cannot proceed to estimate income in an ad-hoc manner. Estimation of profit is permissible only when the books are found to be unreliable or defective to such an extent that correct income cannot be deduced. In the present case, though the AO has made certain general observations regarding self-made vouchers and absence of complete details, no categorical finding has been

recorded that the books are incorrect or incomplete so as to warrant the rejection of books of accounts.

11.1 We further note that the primary reason for the addition is the fall in net profit rate from 3.13% in the earlier year to 1.94% in the year under consideration, despite increase in turnover. However, it is a settled position that mere decline in profit rate cannot be a ground for making addition unless it is supported by tangible evidence showing suppression of income or inflation of expenses. The assessee has furnished a plausible explanation that due to increase in competition, she introduced free delivery services and incurred higher expenditure on transportation, loading and unloading, and conveyance. It is also explained that employees were engaged for collection of dues, resulting in higher conveyance expenses. These explanations, in our view, are normal business phenomena and cannot be brushed aside without bringing any contrary materials on record.

11.2 The AO has mainly doubted the expenses on the ground that some vouchers are self-made, certain vouchers do not contain vehicle numbers or acknowledgements, and petrol expenses are recorded in uniform amounts. While these observations may raise some suspicion, they do not automatically lead to the conclusion that the entire expenses are unverifiable or bogus. In small and medium scale businesses, especially in trading activities, it is quite common that certain expenses are supported by internal vouchers. The AO has not pointed out any specific instance where the expenditure is found to be false or not incurred for business purposes. In absence of such specific findings, disallowance based on general observations is not sustainable.

11.3 Another important aspect which we find lacking in the approach of the AO is that the estimation made is purely ad-hoc. The AO has simply increased the net profit by 1% of the turnover without assigning any rational basis. No comparable cases in similar line of business have been brought on record. No history of the assessee has been properly analysed to justify such enhancement. Even the Ld. CIT(A), while confirming the addition, has only relied on the observations of the AO without independently examining whether the estimation has any reasonable or scientific basis. In our considered view, estimation of income must be based on some objective criteria such as past results of the assessee, industry norms, or comparable cases. An arbitrary increase without such basis cannot be sustained in law.

11.4 We also find merit in the contention of the assessee that with increase in turnover, certain expenses are bound to increase, and they may not necessarily follow the same pattern as in earlier years. Business decisions such as providing free delivery or incurring higher logistics cost to retain customers are commercial decisions, and the tax authorities cannot sit in the judgment over the same unless it is shown that such expenditure is not genuine or not incurred wholly and exclusively for business purposes.

11.5 Considering the totality of facts and circumstances, we are of the view that the addition made by the AO is based on suspicion and surmises rather than on concrete evidence. The approach adopted lacks a reasonable and scientific basis. In the absence of rejection of books and in the absence of any specific defect leading to inflation of expenses, the ad-hoc estimation of profit cannot be sustained.

Accordingly, we set aside the finding of the Ld. CIT(A) on this issue and direct the AO to delete the addition of Rs. 2,99,031/- only. Hence, the ground of appeal raised by the assessee is hereby allowed.

12. The next issue raised by the assessee through Ground Nos. 3 to 5 is that the learned CIT(A) erred in confirming the addition of Rs. 12 Lakh by treating the amount received from Manoj Kumar Sharma and Manoj Kumar Sharma HUF as undisclosed income.

13. The necessary facts are that the assessee during the year has received unsecured loan of Rs. 4 Lakh from her husband Shri Manoj Kumar Sharma and Rs. 8 Lakh from Manoj Kumar Sharma HUF. The AO treated the same as unexplained credit under section 68 of the Act by holding the bank statement of the lender was not furnished and the creditworthiness of lender was not established who has declared income of Rs. 5,13,510/- and Rs. 3,84,420/- in their respective return of income. The AO also noted that no interest was paid on the impugned borrowing. Hence, the AO made addition of Rs. 12 Lakh to the total income of the assessee.

14. The aggrieved assessee preferred an appeal before the learned CIT(A), however the learned CIT(A) confirmed the finding of the AO by observing as under:

*6.2 Regarding the addition of Rs.12,00,000/- u/s 68 of the Act, it is noted that the appellant received unsecured loans from two parties: Shri Manoj Kumar Sharma (Rs.9,00,000) and Manoj Kumar Sharma (HUF) (Rs.3,00,000). During assessment proceedings, notices u/s 133(6) of the Act were issued to the creditors, but bank statements and other primary evidence to establish creditworthiness were not furnished. Their returned incomes were not commensurate with the amounts advanced. No interest payment, repayment schedule, or business justification was shown. During appellate proceedings also, no additional documentary evidence such as bank statements, fund flow*

*statements, or confirmations with proof of financial capacity were produced. Mere filing of confirmations or ITRs is insufficient to prove creditworthiness or genuineness of the transactions. The assessee has therefore failed to discharge the onus u/s 68 of the Act. The addition of Rs.12,00,000/- made by the AO is accordingly upheld.*

15. Being aggrieved by the order of the learned CIT(A), the assessee is in appeal before us.

16. The learned AR before us submitted that the addition made under section 68 of the Act is unjustified and contrary to settled legal principles. It was contended that the assessee has duly discharged the onus cast upon her by establishing the identity of the creditors, their relationship, and the genuineness of the transactions. The lenders are close family members, namely the husband and his HUF, whose identity is undisputed. The Id. AR argued that merely because the bank statements were not furnished or income declared is comparatively lower, the same cannot be a ground to treat the loans as unexplained. Creditworthiness cannot be examined only with reference to current year income, as loans can be advanced out of past savings, capital, or other sources. It was further submitted that in family transactions, non-charging of interest is a common practice. No adverse material has been brought on record by the AO to show that the funds belonged to the assessee. Hence, the Id. AR prayed for the deletion of the addition made by the Revenue.

17. On the other hand, the learned DR before us supported the orders of the AO and the learned CIT(A). The DR submitted that the assessee failed to discharge the primary onus under section 68 of the Act to establish the creditworthiness of the lenders and genuineness of the transactions. The DR thus prayed for upholding the addition.

18. We have heard the rival contentions of both the parties and perused the materials available on record. The issue before us is regarding the addition of Rs. 12,00,000/- made u/s 68 of the Act in respect of unsecured loans received from Shri Manoj Kumar Sharma and Manoj Kumar Sharma (HUF). At the outset, we note that the lenders are close family members of the assessee, namely her husband and his HUF. The identity of the creditors is not in dispute, and the transactions have not been found to be fictitious. Thus, the primary requirement of establishing identity stands satisfied.

18.1 Coming to the objection of the AO that the returned income of the lenders is not commensurate with the amount advanced, we find that this reasoning is not sustainable. The AO has compared the loan amount of Rs. 12 Lakh with the income declared by the lenders in a single year, which is around Rs. 9 Lakh in aggregate. In our considered view, such comparison is fundamentally flawed. Creditworthiness cannot be judged only with reference to income of one year. A person may advance loan out of past savings, accumulated capital, withdrawals from bank, or other sources such as sale of assets or family funds. The Act does not mandate that loan must be given only out of current year income. Therefore, merely because the income declared in a particular year is lower than the amount advanced, it cannot be concluded that the lender lacks creditworthiness.

18.2 We further note that the AO has not brought any material on record showing that the funds emanated from the assessee or that the lenders did not have the financial capacity. No enquiry has been carried

out to examine the overall financial position of the lenders. The addition is thus based only on presumption and not on concrete evidence.

The AO has also placed reliance on non-furnishing of bank statements and absence of interest payment. In our view, these factors alone cannot lead to adverse inference in the facts of the present case. It is quite common in family transactions that loans are given without charging interest and without formal documentation. The relationship between the parties and surrounding circumstances have to be considered in a pragmatic manner.

18.3 We also find that the Ld. CIT(A) has confirmed the addition without addressing the fundamental issue that comparison of loan amount with current year income is not a valid test of creditworthiness. There is no finding that the explanation of the assessee is false or that the transactions are not genuine.

18.4 Considering the totality of facts, we are of the view that the assessee has discharged the initial onus cast upon her u/s 68 of the Act. In absence of any contrary material brought on record by the Revenue, the addition cannot be sustained. Accordingly, we set aside the finding of the Ld. CIT(A) and direct the AO to delete the addition of Rs. 12,00,000/- made by him. Hence, the grounds raised by the assessee are allowed.

19. The issue raised in the Ground Nos. 6 & 7 are in relation to not giving proper opportunity and addition made based on surmises and suspicion. As we have already deleted the addition on the merit. We do not find reason to adjudicate this ground as these grounds become

academic and redundant. Hence, we dismiss the ground Nos. 6 & 7 of the assessee's appeal as infructuous.

20. The Ground Nos. 8 & 9 of the assessee's appeal pertains to levy of interest under section 234B & 234D of the Act which is consequential in nature and does not require any separate and independent adjudication. Hence the same is hereby dismissed as infructuous.

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

Order pronounced in court on 8<sup>th</sup> day of May, 2026

Sd/-

**(SOUNDARARAJAN K)**

Judicial Member

Bangalore

Dated, 8<sup>th</sup> May, 2026

/ vms /

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

Sd/-

**(WASEEM AHMED)**

Accountant Member

By order

Asst. Registrar, ITAT, Bangalore