

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATE: 27.10.2015.

CORAM

THE HON'BLE MR.JUSTICE V.RAMASUBRAMANIAN
AND

THE HON'BLE MR.JUSTICE T.MATHIVANAN

T.C.(A) Nos.1091 and 1092 of 2006

N.Mohammed Ali

Appellant

vs.

The Income Tax Officer,
Ward VIII(2)
Chennai 600 006.

Respondent

Tax Case (Appeal) against the common order dated 26.10.2010 passed by the Income Tax Appellate Tribunal "B" Bench, Chennai in I.T.A.Nos.1035/Mds/2005 and 272/Mds/2005.

For appellant : Mr.S.Sridhar

For Respondents : Mr.M.Swaminathan assisted by
Ms.V.Pushpa

COMMON JUDGMENT

(Judgment of the Court was delivered by V.RAMASUBRAMANIAN, J.)

Both the appeals, filed under section 260A of the Income Tax Act, 1961, were admitted on the following substantial questions of law:-

"1) Whether the Appellate Tribunal is correct in

upholding the order of the Commissioner of Income Tax in revising the assessment for the assessment year 2000-2001 under Section 263 of the Act to disallow the cash purchases in terms of Section 40A(3) of the Act?

2) Whether the Appellate Tribunal is correct in confirming the validity of the assumption of jurisdiction of the Commissioner of Income Tax in terms of Section 263 of the Act for revising the order of assessment relating to the assessment year 2000-2001?

3) Whether the Tribunal is correct in confirming the applicability of the provisions of Section 40A(3) of the Act while justifying the disallowance at 20% of the total cash purchases made in the assessment year 2000-2001 and 2001-2002?

4) Whether the Tribunal is correct in overlooking the business compulsions and expediency in making the cash purchases on the facts and in the circumstances of the case in the assessment years under consideration which would make the said provisions of Section 40A(3) of the Act inapplicable to make the disallowance

contemplated?

5) Whether the Tribunal is correct in concluding that Rule 6DD of the Income Tax Rules, 1962, had no application to the cash purchases inspite of the fact that the fire crackers purchased by cash under compelling circumstances were manufactured without aid of power in a cottage industry?"

2. Heard Mr.S.Sridhar, learned counsel for the appellant and Mr.M.Swaminathan, learned standing counsel for the Department.

3. The appellant/assessee is carrying on business of dealing in stationery. It appears that during festive seasons, the appellant/assessee also carried on business in purchase and sale of crackers.

4. For the assessment year 2001-2002 the assessee purchased crackers for a value of Rs.1,12,51,956/-. Excepting two payments to the total value of Rs.9,50,000/-, which were paid by way of cheques, the remaining payments were made by the assessee by way of cash. Since many of those payments were in excess of Rs.20,000/-, the assessee was denied deduction in terms of section 40A(3). The assessing officer also held that the case was not covered by the

exceptions provided under Rule 6DD of the Income Tax Rules, 1962.

5. As a consequence, the assessing officer disallowed 20% of the cash purchases made in excess of Rs.20,000/-. This resulted in addition of Rs.20,53,191/-.

6. On an appeal by the assessee, the assessee contended that business expediency compelled him to make such payments. But, the Commissioner of Income Tax (Appeals) rejected the appeal.

7. Therefore, the assessee filed a further appeal in I.T.A.No.272 of 2005.

8. In the meantime, a notice under section 263 was issued on 18.2.2005 in respect of assessment year 2000-2001, pointing out that the assessment in relation to the year 2000-2001 was erroneous and had resulted in an order prejudicial to the interest of the Revenue. Though there were also other reasons, the main reason for the issue of a show cause notice under section 263 was that the assessee had purchased crackers for a total amount of Rs.20,00,000/- and that out of the same, only two payments were for an amount less than Rs.20,000/-. Other payments, which were far in excess of Rs.20,000/-, had been made by way of cash. Therefore, by the notice issued under section 263, the Commissioner of income Tax sought to

disallow the claim under section 40A(3).

9. The assessee submitted a reply on 28.2.2005 claiming business expediency with reference to the seasonal nature of the business. The assessee also relied upon the decision in COMMISSIONER OF INCOME TAX v. CHOWDHARY AND COMPANY ((1996) 216 ITR) (Allahabad) and P.M.ABDUL RAZAK v. INCOME TAX OFFICER ((1997) 63 ITD). But, the Commissioner of Income tax overruled the objections and passed order dated 30.3.2005 disallowing the claim under section 40A(3) and directing the assessing officer to modify the assessment.

10. As against the said order of assessment, the assessee filed appeal in I.T.A.No.1035 of 2005. Since I.T.A.No.1035 of 2005 arose out of an order passed under section 263 in relation to the assessment year 2000-2001, it was taken alongwith I.T.A.No.272 of 2005 that arose out of regular assessment proceedings in respect of the assessment year 2001-2002. Both the appeals were dismissed by the Income Tax Appellate Tribunal by a common order dated 26.10.2005. It is against the said common order, the assessee has come up with the above appeals.

11. Out of the five questions of law framed by this court on

26.6.2006 while admitting the above appeals, the first two questions revolve around the assumption of jurisdiction by the Commissioner under section 263. The third question relates to the applicability of section 40A(3). The fourth question relates to the issue of business expediency. The fifth question relates to the application of Rule 6DD. Therefore, we shall deal with these questions in the same order.

12. Questions 1 and 2:- The question of assumption of jurisdiction under section 263 can be disposed of without much ado. Section 263(1) empowers the Commissioner to call for and examine the record of any proceedings under the Act. If the Commissioner considers, upon such examination, that any order passed by the assessing officer was erroneous insofar as it is prejudicial to the interest of the Revenue, the Commissioner may pass an order modifying the order, of course, after issuing a show cause notice and holding an enquiry. Therefore, two requirements are to be satisfied under section 263(1). They are (1) that the order passed by the assessing officer is considered by the Commissioner to be erroneous and (2) that such error has, actually, been prejudicial to the interest of the Revenue.

13. In the case on hand, a scrutiny assessment was made in

relation to the assessment year 2000-2001 on 31.3.2003. It was an assessment made under section 143(3) of the Act. In para 3 of the said order, the assessing officer took note of the fact that the assessee was engaged in seasonal business of selling crackers apart from the routine business of dealing in stationery items and that he did a turnover to the extent of Rs.19.48 lakhs. A declaration to the said effect was also filed only on 25.3.2003 in the course of scrutiny assessment proceedings. In other words, but for the scrutiny assessment, we do not know whether this could have, actually, come to light.

14. Without examining the details of the expenditure involved, the assessing officer accepted the sales turnover reported by the assessee and allowed the benefit of deduction under section 40A(3). The question as to whether the assessee had made payments in excess of Rs.20,000/- on a single day to a single person was not examined by the assessing officer. This is an error that led the Commissioner to initiate proceedings under section 263.

15. The fact that this aspect was not gone into by the assessing officer in his scrutiny assessment order dated 31.3.2003 is borne out from para 3 of the said order. Once it is seen that such an error was

committed, the next question is as to whether the same was prejudicial to the interest of the Revenue or not. The answer to this question is too obvious for any elaborate detail.

16. If the assessee is not entitled to a deduction under section 40A(3), the income chargeable to tax will go up and the tax payable by him will naturally go up. If it is not, the benefit goes to the assessee. Therefore, it is clear that this is a case which satisfies the twin requirements under section 263(1). Consequently, questions 1 and 2 are answered against the assessee.

17. Question No.3:- As we have stated earlier, the third question relates to the applicability of the provisions of section 40A(3). Section 40A deals with expenses or payments not deductible in certain circumstances. Under sub-section (3) of section 40A, any expenditure incurred by an assessee, if made to a person in a day, otherwise than by way of an account payee cheque drawn on a bank or account payee in excess of Rs.20,000/-, no deduction can be allowed. The details furnished in the show cause notice dated 18.2.2005 by the Commissioner show that the assessee had admittedly made payments of Rs.1,00,000/- on three different dates viz., 1.10.1999, 14.10.1999 and 20.10.1999. The assessee had made payments of Rs.2,00,000 on

31.10.1999, 2.11.1999 and 3.11.1999. All those payments are indicated in the books of accounts of the assessee to have been made to a supplier by name "Standard Fireworks". Similarly payments have been made to another supplier by name "Sivakasi Fireworks". Since the name of one supplier mentioned in the books of accounts of the assessee himself to whom a payment of more than Rs.20,000/- had been made on everyone of those days, the contingencies stipulated in sub-section (3) of section 40A have arisen. Hence, the third question is answered against the assessee.

18. Question No.4:- The fourth question revolves around business expediency. This question has arisen for consideration in view of the proviso found in sub-section (3) of section 40A. At this stage, it would be relevant to extract sub section (3) as well as proviso to sub-section (3) which reads as under:-

"Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, no deduction shall be allowed in respect of

such expenditure.

Proviso to (3A) reads as follows:-

"Provided that no disallowance shall be made and no payment shall be deemed to be profits and gains of business or profession under sub-section (3) and this sub-section where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors;

19. As seen from the proviso, the question in relation to sub-section (3) has to be examined with reference to the three things indicated in the proviso. They are (1) the nature and extent of banking facilities (2) considerations of business expediency and (3) other relevant factors.

20. In other words, under sub-section (3), where an assessee

incurs an expenditure which involves payment of more than Rs.20,000/- to a single person on a single day, he is not entitled to any deduction in respect of such expenditure. The rule under sub section (3) is not very rigid. It admits of three exceptions, which are narrated in the proviso. If an assessee could prove that having regard to the nature and extent of banking facilities, or having regard to the consideration regarding business expediency or having regard to the other relevant factors, it would not be possible for him to make payments by way of cheque or demand draft, the assessee would, still, be entitled to deduction. Therefore, it is for the assessee to prove the existence of (1) nature and extent of banking facility that compelled him to make payment in cash (2) consideration of business expediency that compelled him to make payments in cash and (3) any other relevant factors that would justify such a payment.

21. In the case on hand, the books of accounts maintained by the assessee reflected that payments were made to three different suppliers. One was Standard Fireworks, the second was Indira Prints Pack and the third supplier was Sivakasi Fireworks. But, insofar as, Indira Prints Pack is concerned, payment was less than Rs.20,000/-. Therefore, that has not led to any problem. But, insofar as the other

two suppliers are concerned, the books of accounts reflect that payments in excess of Rs.20,000/- to each one of those two suppliers was made on a day to day basis. This is seen from the tabulation given in the show cause notice under section 263, which reads as follows:-

<i>Name of supplier</i>	<i>Date of payment by cash</i>	<i>Amount</i>	<i>Remarks</i>
Standard Fire Works	27.07.1999	1,200.25	
	01.10.1999	100,000	
	14.10.1999	100,000	
	20.10.1999	100,000	
	28.10.1999	150,000	
	31.10.1999	200,000	
	01.11.1999	159,000	
	02.11.1999	200,000	
	03.11.1999	200,000	
	04.11.1999	196,109.8	
	24.11.1999	150,000	
	28.01.2000	50,000	
Indira Prints Pack	06.10.1999	8,750	
Sivakasi Fire Works	05.11.1999	200,000	
	06.11.1999	200,000	
	06.11.1999	42,709.8	

22. In response to the show cause notice, the assessee submitted that they were not purchasing crackers from the companies themselves, but, were purchasing the crackers from the agents and

retailers in the villages. The relevant para of the defence taken by the assessee in their reply to the show cause notice is extracted as under:-

"The retailers in the villages closes their shops after days business and visits the city for their requirements of purchases in late evening hours. They come to city by night 9 pm or so and the crackers business starts only after 9 pm. It goes upto 1 pm in the night. The parcels are made in the night only and the shop is opened in the next day by 11 am or so.

The assessee has made payments in cash each less than Rs.20,000/- only to the agent. The seller's representative visits the shop and collects the sale proceeds every now and then, and issue valid receipts. This happens, normally and mainly everyday evening upto night 1 pm."

23. But, unfortunately, the books of accounts do not disclose (1) either that payments were made to agents of those suppliers or (2) that such payments were made in bits and pieces. The table which

we have extracted above shows the consolidation of payments made on every day to everyone of those suppliers. Sub-section (3) uses even the expression "aggregate of payment made to a person in a day" Therefore, any amount of explanation that the assessee gave in response to the show cause notice, could not have gone against the very entries made in the books of accounts.

24. We are not for a moment to be understood to suggest that the books of accounts should have been more carefully drawn. All that we are suggesting is that atleast the names of the agencies or agents or retailers to whom payments were made on a day to day basis, on behalf of the original manufacturers should have been mentioned. In the absence of any specific detail, the vague statements made in response to the show cause notice, cannot offset the entries made in the books of accounts. Therefore, we cannot find fault with the conclusion reached either by the Commissioner or by the Tribunal in this regard. Hence, the fourth question of law is answered against the assessee.

25. Coming to the fifth question which revolves around Rule 6DD of the Income Tax Rules, 1969, it is seen that Rule 6DD speaks about exceptional circumstances. Some of the exceptional circumstances

that would meet the requirements of the Rule are indicated in Circular No.220 dated 31.5.1977 that reads as follows:-

"Illustrative situations of 'exceptional circumstances' - All the circumstances in which the conditions laid down in rule 6DD(j) would be applicable cannot be spelt out. However, some of them which would seem to meet the requirements of the said rule are:

- (a) the purchaser is new to the seller; or
- (b) the transactions are made at place where either the purchaser or the seller does not have a bank account; or
- (c) the transactions and payments are made on a bank holiday; or
- (d) the seller is refusing to accept the payment by way of crossed cheque/draft and the purchaser's business interest would suffer due to non-availability of goods otherwise than from this particular seller; or
- (e) the seller, acting as a commission agent, is

required to pay cash in turn to persons from whom he has purchased the goods; or

(f) specific discount is given by the seller for payment to be made by way of cash. - Circular No.220 (F.No.206/17/76-IT(A-II)), dated 31.5.1977."

26. Unfortunately, the assessee neither pleaded nor proved the existence of any one of those circumstances indicated in Rule 6DD. Therefore, Rule 6DD cannot also go to the rescue of the appellant/assessee. Hence, the fifth question of law is also to be answered against the assessee. Accordingly, it is answered. In the result, both the Tax Case Appeals are dismissed. No costs.

(V.R.S.,J.) (T.M.,J.)
27.10.2015.

Index: Yes/No.
Internet: Yes/No.
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To

1. Income Tax Appellate Tribunal
"B" Bench, Chennai.

2. The Income Tax Officer,
Ward VIII(2)
Chennai 600 006.

V.RAMASUBRAMANIAN, J.
AND
T.MATHIVANAN, J.

Ssk.

T.C.(A) Nos.1091 and 1092 of 2006

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