

In the High Court of Judicature at Madras

Dated : 08.09.2020

Orders reserved on 31.08.2020	Orders pronounced on 08.09.2020
----------------------------------	------------------------------------

Coram :

The Honourable Mr.Justice T.S.SIVAGNANAM
and
The Honourable Mrs.Justice PUSHPA SATHYANARAYANA

Tax Case Appeal No.759 of 2018

Principal Commissioner of Income Tax 1,
63, Race Course Road,
Coimbatore - 641 018.Appellant/Respondent

Vs

M/s.Sumukha Synthetics,
Race Course Mansion,
2nd Floor, 8/1-M, Race Course,
Coimbatore - 641 018
PAN: AAXFS3967MRespondent/Appellant

APPEAL under Section 260A of the Income Tax Act, 1961
against the order dated 16.03.2018 in ITA No.1176/Chny/2017 on
the file of the Income Tax Appellate Tribunal Chennai 'C' Bench
for the assessment year 2005-06 and against the order of the
Commissioner of Income Tax (Appeals)-2, Coimbatore dated
27/02/2017 in ITA No.50/15-16 and against the order of the
Assistant Commissioner of Income Tax, Non Corporate, Circle-2,
Coimbatore dated 28/03/2015 in PA No.GIR No.AAXFS3967M.

For Appellant : Mr.T.R.Senthil Kumar
Senior Standing Counsel
Assisted by M/s.K.G.Usha Rani
Junior Standing Counsel

For Respondent : Mr.Rahul Balaji
Assisted by M/s.Janani Shankar

JUDGMENT

Judgment was delivered by T.S.SIVAGNANAM, J

This appeal by the assessee filed under Section 260A of the Income Tax Act, 1961 ("the Act" for brevity), is directed against the order dated 16.03.2018 in ITA No.1176/Chny/2017 on the file of the Income Tax Appellate Tribunal Chennai 'C' Bench for the assessment year 2005-06.

2.The appeal was admitted on 16.12.2019 on the following substantial questions of law:

"1.Whether the Appellate Tribunal is correct in holding that the assessee is entitled for allowable expenditure u/s.40A(3) even though the transaction undertaken by the assessee was in contravention of section 40A(3) of the Income Tax Act?

2.Whether the Tribunal was right in holding the decision of the Hon'ble Supreme Court in the case of Attar Singh Gurumukh Singh as applicable in the assessee's case without appreciating that the decision was with reference to Rule 6DD(j) which was omitted w.e.f. 01.04.1996?"

3.The assessee is a partnership firm filed its return of income for the relevant assessment year AY 2005-06 on 31.03.2005 declaring a total income of Rs.23,29,830/-. The assessment was completed under Section 143(3) of the Act. The Commissioner of Income Tax exercised his power under Section 263 of the Act on the ground that certain payments made by the assessee to M/s.Sitalakshmi Mills Ltd. ['M/s.SLM' for brevity] towards conversion charges paid by cash were omitted to be disallowed under Section 40A(3) of the Act. After hearing the assessee, the Commissioner set aside the assessment order and directed the Assessing Officer to make fresh assessment after considering the applicability of Section 40A(3) of the Act. On such direction, the Assessing Officer made an addition of Rs.61,32476/- under Section 40A(3) being 20% of total cash payment of Rs.3,06,62,382/-. Aggrieved by the same, the assessee preferred appeal to the Commissioner of Income Tax (Appeals)[CITA(A)] which was dismissed. The assessee challenged the said order before the Tribunal which set aside the order passed by the CIT (A) and directed to re-examine the issue of disallowance under Section 40A(3) and whether the assessee is entitled for exemption under Rule 6DD in respect of payments made in cash. Pursuant to such direction, the Assessing Officer passed an order on 28.03.2015 under Section 143 r/w. 254 of the Act and sustained the addition. Aggrieved by the same, the assessee preferred appeal before the CIT(A) which was dismissed by order

dated 27.02.2017. Challenging the same, the assessee preferred appeal before the Tribunal which was allowed by the impugned order. Aggrieved by the same, the revenue is before us by way of an appeal.

4. We have elaborately heard Mr. T. R. Senthilkumar, learned senior standing counsel assisted by Mr. K. G. Usharani, learned junior standing counsel appearing for the appellant, Mr. Rahul Balaji, learned counsel assisted by M/s. Janani Shankar, learned counsel appearing for the respondent and carefully perused the materials placed on record.

5. The question which falls for consideration is whether the disallowance under Section 40A(3) of the Act as made by the Assessing Officer is sustainable and the extent of applicability of Rule 6DD of the Income Tax Rules. For better appreciation, Section 40A(3) and Rule 6DD are quoted herein below:

"Section 40A(3): 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, or use of electronic clearing system through a bank account [or through such other electronic mode as may be prescribed], exceeds ten thousand rupees, no deduction shall be allowed in respect of such expenditure."

Rule 6DD: No disallowance under sub-section (3) of section 40A shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3A) of section 40A 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 the cases and circumstances specified hereunder, namely:-

- (a) where the payment is made to-
 - (i) the Reserve Bank of India or any banking company as defined in clause 9c0 of section 5 of the Banking Regulation act, 1949 (10 of 1949)
 - (ii) the State Bank of India or any subsidiary bank as defined in section 2 of the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959)
 - (iii) any co-operative bank or land mortgage bank
 - (iv) any primary agricultural credit society or any primary credit society as defined under section 56 of the Banking Regulation Act, 1949 (10 of 1949)
 - (v) the Life Insurance Corporation of India

established under section 3 of the Life Insurance Corporation Act, 1956 (31 of 1956);

(b) where the payment is made to the Government and under the rules framed by it, such payment is required to be made in legal tender;

(c) where the payment is made by-

(i) any letter of credit arrangements through a bank;

(ii) a mail or telegraphic transfer through a bank;

(iii) a book adjustment from any account in a bank to any other account in that or any other bank;

(iv) a bill of exchange made payable only to a bank;

(v) the use of electronic clearing system through a bank

(vi) a credit card;

(vii) a debit card.

Explanation: For the purposes of this clause and clause (g), the term "bank" means any bank, banking company or society referred to in sub-clauses (i) to (iv) of clause (a) and includes any bank [not being a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949)], whether incorporated or not, which is established outside India;

(d) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;

(e) where the payment is made for the purchase of-

(i) agricultural or forest produce; or

(ii) the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or

(iii) fish or fish products; or

(iv) the products of horticulture or apiculture, to the cultivator, grower of such articles, produce or products;

(f) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;

(g) where the payment is made in a village or town, which on the date of such payment is not

served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;

(h) where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed fifty thousand rupees;

(i) where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of section 192 of the Act, and when such employee—

(i) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship; and

(ii) does not maintain any account in any bank at such place or ship;

(j) where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;

(k) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;

(l) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

Explanation:- For the purposes of this clause, the expressions "authorised dealer" or "money changer" means a person authorised as an authorised dealer or a money changer to deal in foreign currency or foreign exchange under any law for the time being in force.

In terms of the above provision, the assessee is prohibited from effecting cash payments over and above Rs.20,000/-. Rule 6DD states that no disallowance under Sub-section (3) of Section 40A shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3A) of section 40A 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 an account payee bank draft exceeds Rs.20,000/- in the case and circumstances specified in clauses

(a) to (1) of Rule 6DD.

6.It is the argument of the revenue that none of the contingencies mentioned in clauses (a) to (1) in Rule 6DD are attracted in the instant case. Further, it is submitted that the Assessing Officer rightly held that the decision in th case of Attar Singh Gurumukh Singh vs. ITO [(1991) 191 ITR 667] is not applicable to the facts and circumstances of the case because the Punjab National Bank had directed M/s.SLM to immediately close their account with the State Bank of India, Sivagangai and all transactions should be routed through their account in their bank. It is submitted that this direction was issued because M/s.SLM had been declared as a sick industry in the year 1999, Punjab National Bank was appointed as an operating agency and the said Company was under a scheme of rehabilitation and in the path of recovery. Therefore, it is submitted that it is not as if there is no banking facility available to bring the case of the assessee within the ambit of proviso under sub-section (3) of Section 40A nor it can be considered as a business expediency nor there are any other relevant factors to justify such huge payments in cash. The revenue placed reliance on the decision in the case of CIT, Madurai vs. Venkatadhri Constructions [(2013) 31 taxmann.com 71 (Madras)], P.K.Ramasamy Nadar & Bros. vs. Income Tax Officer, Ward-I(3), Virudhunagar [(2014) 41 taxmann.com 538 (Madrs)], Natesan Krishnamurthy vs. ITO, Non-Corporate Ward 9(2), Chennai [(2019) 103 taxmann.com 342(Madras)], N.Mohammed Ali vs. ITO, Ward-VII(2), Chennai [(2016) 65 taxmann.com 189(Madras)] and Cit VS. A.D.Jayaveerapandia Nadar & Sons [(2007) 162 taxmann 195 (Madras)].

7.These decisions have been relied on by the revenue for the proposition that even though Section 40A(3) is not absolute, payments made in cash cannot automatically be allowed merely for the reason that payments were made to a person who is identifiable, more particularly, when the cash payments were effected to avoid the attachment of the bank account of M/s.SLM at the instance of the Employees State Insurance Corporation, Madurai. These decisions have also been relied on to state that the reason assigned by the assessee cannot be a business expediency nor as the assessee brought the circumstances to be a relevant factor to be considered in terms of the proviso under sub-section (3A) of Section 40A. The assesee seeks to resist the appeal by contending that there is no substantial question of law involved in the present appeal and the Tribunal considered the facts and circumstances and granted relief to the assessee which does not warrant any interference. The decision in Attar Singh Gurumukh Singh was rightly applied by the Tribunal as in the said case while testing the vires of Section

40A(3), the Hon'ble Supreme Court has explained the reason behind the introduction of the said provision and has held that where the payment is genuine there cannot be denial of deduction of genuine and bonafide business expenditure merely because the assessee could not make the payment as provided under Section 40A(3) of the Act. The learned counsel for the assessee placed reliance on the decision in the case of Walford Transport (Eastern India) Ltd. vs. Commissioner of Income Tax [(1999) 240 ITR 902][Para 10], CIT vs. Rhydburg Pharmaceuticals Ltd. [(2004) 269 ITR 561][Para 2]. Further it is argued that Rule 6DD of the Rules merely sets out the circumstances under which the assessee can claim exemption provided under Section 40A(3) and it is illustrative and not exhaustive in this regard and reliance was placed on the decision in the case of CIT vs. Chrome Leather Co. Pvt. Ltd. [(1999) 235 ITR 708][Para 8] and Giridharlal Goenka vs. CIT [MANU/WB/0114/1988][Para 14].

8. Further it is submitted that there is adequate evidence to prove that the assessee was compelled to make cash payment for the conversion work undertaken by M/s.SLM as it had incurred expenditure for restructuring its machinery to enable to cater to the need of the assessee and maintain quality. The learned counsel also distinguished the decisions relied on by the revenue and submitted that the transaction was genuine and bonafide in nature which are very relevant to test the conduct of the assessee. After carefully going through the decisions cited at the Bar, the underlying legal principle which emerges from all these decisions is the satisfaction which has to be recorded by the Assessing Officer as regards the conduct of the assessee in effecting cash payments over and above the amounts stipulated under Section 40A(3) of the Act. In terms of the first proviso under Section 40A(3A), it is the assessee who has to set out the circumstances which led to effect payment in cash in excess of the amounts stipulated in Section 40A(3) and this explanation needs to be tested having regard to the nature and extent of banking facilities, consideration of business expediency and other relevant facts. The Hon'ble Division Bench in Chrome Leather Co. Pvt. Ltd. was testing the correctness of the order passed by the Tribunal holding that the assessee in the said case was not entitled to any relief from the order of the Assessing Officer who disallowed its claim under Section 40A(3). After referring to the decision in Attar Singh Gurumukh Singh, it is held as follows:

"7. Mr. Janarthana Raja, learned counsel for the assessee, on the other hand, submitted that the Tribunal has come to the conclusion that the provisions of rule 6DD of the Income-tax Rules were satisfied and the Tribunal has come to the conclusion that the provisions of rule 6DD of the Income-tax Rules were fully complied with and,

hence, it is not open to the Revenue to challenge the finding of fact by the Appellate Tribunal.

8. We have considered the rival contentions. The provisions of section 40A(3) of the Income-tax Act along with rule 6DD of the Income-tax Rules deal with the subject of payment made by the assessee in cash and not by cheque or draft for more than the prescribed amount. The constitutional validity of the provisions of section 40A(3) of the Income-tax Act was the subject-matter of consideration before the Supreme Court in the case of Attar Singh Gurmukh Singh v. ITO [1991] 191 ITR 667, and the Supreme Court, after considering the object of the section held that the payment by crossed cheque or crossed bank draft is insisted upon to enable the assessing authority to ascertain whether the payment was genuine or whether it was out of income from undisclosed sources. The Supreme Court also held that consideration of business expediency and other relevant factors are not excluded in examining the applicability of the provisions of section 40A(3) of the Income-tax Act. Genuine and bona fide transactions, as held by the Supreme Court, are not taken out of the sweep of the section, and it is open to the assessee to furnish to the satisfaction of the Assessing Officer the circumstances under which the payment in the manner prescribed under section 40A(3) was not practicable or would have caused genuine difficulty to the payee. The Supreme Court also held that it is open to the assessee to identify the person who has received the cash payment. It is relevant to notice that rule 6DD of the Income-tax Rules provides that an assessee can be exempted from payment by crossed cheque or crossed bank draft in the circumstances specified in the rule. The above decision of the Supreme Court makes it clear that the assessee can be exempted from the requirements of payment by crossed cheque or crossed bank draft where the purchases are made in certain agricultural or horticultural commodity or from a village where there is no banking facility.

9. The Central Board of Direct Taxes has issued certain guidelines giving certain circumstances, and those circumstances are illustrative and not exhaustive and the underlying idea of the circular is that if the identity of the payee is known, it would be possible for the Income-tax Officer to cross-check whether the transaction had in fact

taken place. The Tribunal took into account the commercial need in keeping cash and referred to the need for keeping cash for making purchases of raw skins from shandies when the upcountry tanneries insist upon payment of ready cash. It was also found that the cheques were rarely accepted. It is no doubt true that the payee is having a bank account in the same branch in which the assessee is having a bank account. But, working hours of the bank are of limited duration. Though both the payee and payer may have accounts in the same branch of the bank, but it may not be possible to issue a crossed cheque after the banking hours. Further, the criticism of Mr. S. V. Subramaniam is that the assessee could have made payments in advance in anticipation of purchase. It is well established that it is not for the Revenue to dictate as to how the assessee should carry on his business. The Appellate Tribunal, after noticing the trade practice and the necessity to keep cash in hand, has found that there was necessity on the part of the assessee to keep substantial cash in its hands to meet contingencies at the time of purchase. It was also found, taking into account other factors, that there was a trade necessity and, issue of crossed cheque would delay the business operation. The Tribunal also found that the issue of crossed cheque is not practicable and having regard to the nature of the transaction and the necessity for expeditious settlement and the nature of the relationship between the payer and payee, it found that the issue of payment by crossed cheque would have caused genuine difficulty to the payee and the identity of the payee is not doubted and there is no reason to doubt the genuineness of the payee in cash payment. The Appellate Tribunal considered all the relevant materials on record and came to the conclusion that there was no justification to disallow the entire payment, merely because cash payments have been made. As regards the other amount of Rs. 6,50,303, the Tribunal examined the materials with reference to item-wise expenditure and found that there was justification for the payments to be made in cash. The Tribunal also found that the identity of the payee was established and the genuineness of the payment was established beyond doubt, and the requirements of section 40A(3) of the Income-tax Act and rule 6DD of the Income-tax Rules were fully satisfied. The finding recorded by the Appellate Tribunal is a

finding arrived at on the facts of the case. The Tribunal has accepted the materials produced before it in support of its finding that only at the time of purchase, the actual amount would be known and the identity of the party was successfully established and the decision of the Tribunal is based entirely on the facts of the case."

9.The above is the legal principle which has been consistently adopted in all matters. What is crucial while testing such a claim and the applicability of Section 40A(3) is the facts of each particular case. Therefore, a decision cannot be taken without referring to facts. The assessee seeks to bring its case under two limbs, namely, there was no banking facility and it was a business expediency. The assessee by stating that there was no banking facility does not seek to bring their case under clause (j) of Rule 6DD but on account of the factual position. On 29.11.2002, the Punjab National Bank sends a letter to M/s.SLM directing them to close the bank account with State Bank of India and directs them to do all banking transactions only through the Punjab National Bank. This direction has come because the said Bank was appointed as the operating agency to implement a scheme of revival of M/s.SLM as framed by the BIFR. Therefore, M/s.SLM cannot flout the direction. The said Company was carrying on business and it appears that the assessee was one of the major entities with whom they had entered into agreement. There was an agreement for "conversion job work" dated 01.04.2004. Even prior to that, on 27.02.2004, the Punjab National Bank informs M/s.SLM that their bank account with them has been attached pursuant to an order passed by the Employees State Insurance Corporation, Madurai and the interest payable towards Punjab National Bank cannot be serviced from the very same account. On receipt of the letter on 02.04.2004 M/s.SLM writes to the assessee informing this development and requesting them to pay cash for meeting the wages, salary and other expenses for their Unit to run smoothly. Further, they have represented for payment of additional conversion charges depending upon the quality of the product as they have incurred lot of expenses in modernising the machineries. These factors led to the assessee effecting payments in cash.

10.The words "extent of banking facilities available" has to be interpreted in the facts of a given case and all such cases will not be covered under clause (j) of Rule 6DD which has been subsequently deleted. In the instant case, banking facility was available but the bank account could not be operated by the very bank themselves because of an order of attachment passed by the ESI Department. M/s.SLM virtually came

to the assessee with the begging bowl and requested to effect payment in cash. The assessee has entered into an agreement for conversion on job work basis. The assessee is required to act as a prudent businessman, so that the job work is completed to his satisfaction with optimum quality. This has led the assessee to effect payments in cash. The argument of the revenue is on the ground that in order to avoid the attachment of the bank account the assessee has effected payment in cash. It is to be noted that what is relevant to be seen insofar as Section 40A(3) is the conduct of the assessee and not the payee. The question would be did the assessee have a reasonable cause to effect payment in cash. If the assessee has a reasonable explanation, then the proviso under Section 3A would stand attracted and the assessee would be entitled to relief. It may be true that merely because the payee is identifiable, it will automatically exonerate the assessee. We are not laying down any such broad principle. The fact that the payee was identifiable and not a fictitious person would go to show the bonafides of the transaction and this is what is required to be considered from the angle of a commercially expedient and prudent business house. Thus, we find that the Tribunal rightly interfered with the order passed by the Assessing Officer as confirmed by the CIT(A) and granted the relief to the assessee.

11. In the result, the tax case appeal is dismissed and the Substantial Question of law is answered against the revenue and in favour of the assessee. No costs.

Sd/-

Assistant Registrar(CCC)

//True copy//

Sub Assistant Registrar

cse

To

1. The Income Tax Appellate Tribunal,
Madras 'C' Bench.

2. The Commissioner of Income Tax (Appeals)-2,
Coimbatore.

3. The Assistant Commissioner of Income Tax,
Non Corporate Circle-2, Coimbatore.

+1cc to Mr.T.R.Senthil Kumar, Advocate SR.No.29577

TCA.No.759 of 2018

KK(CO)

GMV(23/09/2020)