
(2014) 01 GUJ CK 0031
In the Gujarat High Court
Case No : Tax Appeal No. 556 of 2013

Anupam Tele Services

APPELLANT

Vs

Income Tax Officer

RESPONDENT

Date of Decision : 22-01-2014

Acts Referred:

Income Tax Act, 1961 — Section 40A, 40A(3)

Citation : (2014) 268 CTR 121 : (2014) 366 ITR 122 : (2014) 222 TAXMAN 318

Hon'ble Judges : Sonia Gokani, J; Akil Abdul Hamid Kureshi, J

Bench : Division Bench

Advocate : J.P. Shah and Manish J. Shah, Advocate for the Appellant; Sudhir M. Mehta, Advocate for the Respondent

Judgement

Akil Abdul Hamid Kureshi, J.—Appeal is admitted for consideration of following substantial question of law:

Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that s. 40A(3) applies to the payment of Rs. 33,10,194 deposited by the appellant in the bank account of Tata Tele Services Ltd.?

We have heard learned counsel for final disposal of the appeal. Brief facts are as under:

The issue pertains to asst. yr. 2006-07. The appellant-assessee is involved in the business of distribution of mobile and recharge vouchers of Tata Tele Services Ltd. They are the authorized channel partners of the company. They would make payment to the company for purchase of recharge vouchers. The assessee made such payment through account payee cheques till 22nd Aug., 2005, when a circular was issued by Tata Tele Services Ltd. requiring the appellant to deposit cash at the company's office at Surat.

2. During scrutiny assessment, the A.O. noticed that the assessee had made a total payment of Rs. 33,10,194 during the year under consideration to Tata Tele Services Ltd. by cash on different dates and such payment exceeded Rs. 20,000

each. He also noticed that similar payments exceeding Rs. 20,000 in cash were made to one Rajvi Enterprises totalling Rs. 1,37,368 and one payment to M/s. R.D. Infotech of Rs. 31,350.

Prima facie believing that such cash payments exceeding Rs. 20,000 would be hit by s. 40A(3) of the IT Act, 1961 ("Act" for short), the A.O. issued a notice to the assessee why such expenses should not be disallowed.

3. In response to such notice, the assessee contended that it was purchasing recharge vouchers from Tata Tele Services Ltd. The said company issued a circular dt. 22nd Aug., 2005 and instructed the assessee to deposit cash at its office at Surat. Yet another letter was written on 1st Sept., 2005 instructing the assessee to deposit cash and not make payments by cheque or demand draft. The reason why Tata Tele Services Ltd. were not accepting payment by banker's cheque or demand draft was that the assessee had an account with a co-operative bank. It was assured that the cash payment would be deposited in the Bank on behalf of the assessee. It was pointed out that not only the present assessee but all the channel partners/distributors of Tata Tele Services Ltd. in Gujarat were required to make such cash payments. It was pointed out that if the assessee continued to make payment through cheque or demand draft, they would get the recharge vouchers only after 4-5 days which would affect their business. It was contended that the intention of s. 40A(3) is to prevent deduction on bogus payments. The assessee had made cash deposits with a reputed public limited company, which they were liable to do as per the terms and conditions of agreement with the company which they had followed.

4. The AO, however, was not convinced by such reply and held that the payments in cash exceeding Rs. 20,000 violate the provision of s. 40A(3) of the Act and disallowed 20 per cent of Rs. 34,78,912 and thus, added back a sum of Rs. 6,95,782 to the total income of the assessee.

5. The assessee carried the matter in appeal. CIT(A), by his order dt. 12th Nov., 2009, reversed the decision of the A.O. He held and observed as under:

6. I have gone through the submission of the appellant and the observations of the A.O. The fact of cash payment is not disputed. It is a fact that Tata Tele Services Ltd. had intimated that the DD/payee order issued by the assessee's banker namely Saraswat Co-operative Bank Ltd. would be accepted as a cheque and effect delivery after the cheques are cleared which will take 4/5 days. This delay might adversely affect the business of the assessee. The assessee is a distributor of Tata Tele Services Ltd. and can obtain the recharge facilities only after payment made to the principal company. Therefore, the Tata Tele Services Ltd. insisted the company to pay in cash and get immediate delivery to avoid delay and suffering in the market. From 28th Aug., 2005, in accordance with the instruction of Tata Tele Services Ltd., the amounts were paid in cash. Such circumstances need to be kept in mind. The factum of payment made to the Tata Tele Services Ltd. is not disputed. The transactions are genuine. The assessee

had filed a copy of account of Tata Tele Services Ltd. which clearly supports that the payments were made. It has been held by the various Courts that where genuineness of transactions and identity of receivers is established the payments should not be disallowed. It is not the case of the A.O. that the transactions are not genuine nor the payments were not made. Considering the circumstances, the assessee took a very practical step in making the payment to stay in business in a competitive environment. It is not a case where by making such payments the objective underlined in s. 40A(3) has been frustrated. The objective of s. 40A(3) requiring such payments to be made by crossed cheques or drafts has been repeatedly stressed by the Courts as per example in Walford Transport (Eastern India) Ltd. Vs. Commissioner of Income Tax, as under:

From a perusal of the decision of different High Courts referred to above, it clearly emerges that the purpose of s. 40A(3) of the Act is not to penalize the assessee for making cash payment of an amount of Rs. 2,500 or above. The purpose is only preventive and to check evasion of tax and flow of unaccounted money or to check transactions which are not genuine and may be put as camouflage to evade tax by showing fictitious or false transactions.

6.1 The conduct of the assessee in making payments to Tata Tele Services Ltd. being genuine is not inconsistent with the above stated objectives. Therefore, the disallowance under s. 40A(3) in respect of payment made to Tata Tele Services Ltd. is deleted.

6.2 As regards payments made to Rajvi Enterprise and R.D. Infocom are concerned, the same has been genuinely made to the above parties and in some cases are covered by circumstances notified in r. 6DD particularly r. 6DD(j) of the IT Rules, 1962. Therefore, the disallowance under s. 40A(3) is not warranted in respect of such genuine payments. Now, the A.O. is directed to delete the addition on this account.

6. Revenue carried the matter in appeal before the Tribunal. Tribunal allowed the Revenue's appeal. In particular, the Tribunal took into account cl. (j) of r. 6DD of the IT Rules, 1962, which at the relevant time after amendment, read as under:

6DD. No disallowance under sub-s. (3) of s. 40A shall be made where any payment in a sum exceeding two thousand five hundred rupees (sic) is made otherwise than by crossed cheque drawn on a bank or by a crossed bank draft in the cases and circumstances specified hereunder, namely: (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.

7. The Tribunal concluded as under:

The Hon'ble jurisdictional High Court in the case of Hasanand Pinjomal (supra) had interpreted the old provisions of r. 6DD only. The decision of the Special Bench, Calcutta in the case of Kenaram Saha & Subhas Saha (supra) is the latest decision on the applicability of the provisions of s. 40A(3) and is squarely

applicable to the facts of this case according to which the assessee can get exemption from the provision of s. 40A(3) only if he is able to show that his case falls within any of the clauses of r. 6DD of the IT Rules. It has further been held in that case that burden to establish under which particular clause his case falls is also on the assessee. Since the lower authorities have not examined the issue in hand in the light of this decision, we are of the considered opinion that the matter should go back to the file of the A.O. for fresh adjudication to decide the issue in the light of the decisions of Kenaram Saha & Subhas Saha (supra). This ground of the Revenue is allowed for statistical purpose.

16. In the combined result, assessee's appeal is allowed and Revenue's appeal is allowed for statistical purpose.

8. The assessee is therefore in appeal before us.

9. Learned advocate Shri J.P. Shah appearing for the appellant has submitted that any payment made in cash to Tata Tele Services Ltd. was on account of the directives issued by the said company. The assessee had a bank account in a co-operative bank which resulted in delayed release of the amount in favour of the principal. This in turn would delay the assessee getting the recharge vouchers. M/s. Tata Tele Services Ltd. had indicated that such payments would be deposited on behalf of the assessee in the bank account. He, therefore, submitted that there was no breach of s. 40A(3) of the Act. The whole intention behind enactment of the said provision is to curb black money transactions. In the present case when there was no doubt about the genuineness of the payments made and that such payments are reflected in the accounts of the payer as well as payee, rigors of s. 40A(3) should not have been applied. Counsel relied on the decision of the apex Court in case of M/s. Attar Singh Gurmukh Singh, etc. Vs. Income Tax Officer, Ludhiana, etc., in which it was observed that, "the terms of s. 40A(3) are not absolute. Consideration of business expediency and other relevant factors are not excluded. Genuine and bona fide transactions are not taken out of the sweep of the section".

10. Counsel also relied on the decision of Punjab & Haryana High Court reported in Commissioner of Income Tax Vs. Smt. Shelly Passi, in which under somewhat similar circumstances, the Court upheld the view of the Tribunal in not applying s. 40A(3) of the Act to the cash payments when ultimately, such amounts were deposited in the bank by the payee.

11. On the other hand, Shri Sudhir Mehta, learned counsel for the respondent opposed the appeal contending that the payments made by the assessee were clearly covered under s. 40A(3) of the Act. The resultant effect therefore must be allowed to be operated. He would rely on r. 6DD of the IT Rules, 1962 to contend that none of the clauses contained in the said rule would apply in the present case.

12. He relied on the following decisions:

(a) Attar Singh Gurmukh Singh vs. ITO (supra), in which it was observed that the word "expenditure" has not been defined in the Act. It is a word of wide import. Sec. 40A(3) refers to the expenditure incurred by the assessee in respect of which payment is made. It means that all outgoings are brought under the word "expenditure" for the purpose of the section. It was observed that any restraint intended to curb the chances and opportunities to use or create black money should not be regarded as curtailing the freedom of trade or business.

(b) In case of Commissioner of Income Tax Vs. Hynoup Food and Oil Ind. Pvt. Ltd., , wherein, the Division Bench of this Court, in a reference from the Tribunal on a question of law, had an occasion to interpret s. 40A(3) r/w r. 6DD in which, it was observed as under:

16. Whether in the circumstances of the present case is it possible to state that the case of the assessee is governed by the exceptions carved out by r. 6DD(j) of the Rules? The rule has to be read in the context of the second proviso to sub-s. (3) of s. 40A of the Act whereunder a disallowance is not permissible if on consideration of business expediency an assessee is able to satisfy the A.O. that he was required to make payment in cash due to exceptional or unavoidable circumstances, or because payment by a crossed cheque or bank draft was not practicable, and/or would have caused genuine difficulty to the payee, having regard to the nature of the transaction and the necessity for expeditious settlement thereof, and further furnishes evidence to the satisfaction of the A.O. as to the genuineness of the payment and the identity of the payee. Thus, the position is that even if business expediency is established by the assessee concerned, the assessee would be required to show that payment by a crossed cheque or bank draft was not possible due to exceptional or unavoidable circumstances and also furnish evidence to establish genuineness of the transaction and identity of the payee; in the second situation also, after showing business expediency the assessee would be required to establish that it was necessary to make payment in cash because either the payment by crossed cheque or bank draft was not practicable, or would have caused genuine difficulty to the payee, and such impracticability or difficulty to the payee is with regard to the nature of the transaction and the necessity for immediate settlement of the transaction, and simultaneously satisfying the A.O. as to the genuineness of the payment and the identity of the payee.

17. In other words, genuineness of the payment and the identity of the payee are the first and foremost requirement. Even if business expediency gets established, in absence of evidence as to genuineness of the payment and identity of the payee, an assessee cannot seek recourse to either of the two situations laid down in cl. (j) of r. 6DD of the Rules.

(c) In case of Nathalal Jethalal Vs. Commissioner of Income Tax, , Division Bench of this Court, relying on the decision in case of Attar Singh Gurmukh Singh (supra) held that s. 40A(3) would be attracted to payments made for acquiring stock-in-trade and other materials.

(d) In case of K. Abdu and Co. Vs. ITO, , wherein, Kerala High Court held that where the assessee made cash payments to the bank accounts of suppliers maintained with different banks, such payments would not be excluded from s. 40A(3) of the Act.

(e) In case of Commissioner of Income Tax Vs. Venkatadhri Constructions, in which similar view was expressed.

13. We need to answer the question on the facts arising in the present case with the help of the decisions listed before us. The facts before us are more or less undisputed.

14. The appellant-assessee acted as an agent of Tata Tele Services Ltd. for distributing mobile cards and recharge vouchers. For getting such mobile cards and recharge vouchers, the assessee would make payment to Tata Tele Services Ltd. Till a point of time, in the month of August, 2005, such payments were made by account payee cheques. The Tata Tele Services Ltd., however, issued a circular not only to the assessee but to all other distributors in the State stating that the distributors will pay only through demand draft drawn on nationalized bank or through bank deposit slips and where the distributor had a bank account with cooperative bank, the payment should be made in cash., In consonance with such circular, Tata Tele Services Ltd. wrote a letter to the assessee and stated as under:

We further intimate you that your bank is The Saraswat Co-operative Bank Ltd. We treat DD/pay order from your bank as a cheque and your invoice processes done after credit balance in company's account. It will take 4/5 days. It will suffer our business. So please deposit cash at public office of company in Surat and get immediate delivery to avoid suffering of market. We will deposit your cash in our bank on behalf of you. You are very well known that we cannot suffer our business at any cost.

15. In terms of such circular and letter, the assessee thereafter made cash payments to Tata Tele Services Ltd. About the genuineness of payments made, there is no dispute. The full account of the assessee as well as Tata Tele Services Ltd. were placed on record. The assertion of the assessee that such monies were to be deposited by Tata Tele Services Ltd. in their bank account and were eventually so deposited were not disputed. It is precisely on this premise that the appellate CIT observed that the factum of payment to Tata Tele Services Ltd. is not disputed and the transactions were genuine. The assessee had in fact filed a copy of the accounts with Tata Tele Services Ltd. indicating that such payments were made.

16. Sec. 40A(3) of the Act pertains to expenses or payments not deductible in certain circumstances. The said section, as prevalent at the relevant time, read thus:

(3)(a) Where the assessee incurs any expenditure in respect of which payment is

made in sum exceeding twenty thousand rupees otherwise than by an account payee cheque drawn on a bank or account payee bank draft, no deduction shall be allowed in respect of such expenditure;

(b) Where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year (hereinafter referred to as subsequent year) the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income tax as income of the subsequent year if the amount of payment exceeds twenty thousand rupees:

Provided that no disallowance shall be made and no payment shall be deemed to be the profits and gains of business or profession under this sub-section where any payment in a sum exceeding twenty thousand rupees is made otherwise than by an account payee cheque drawn on a bank or account payee bank draft, 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.

17. Rule 6DD of the IT Rules, 1962 provides for situations under which disallowance under s. 40A(3) shall not be made and no payment shall be deemed to be the profits and gains of business or profession under the said section. Amongst the various clauses, cl. (j) which is relevant, read as under:

(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;

18. It could be appreciated that s. 40A and in particular sub-cl. (3) thereof aims at curbing the possibility of on-money transactions by insisting that all payments where expenditure in excess of a certain sum (in the present case twenty thousand rupees) must be made by way of account payee cheque drawn on a bank or account payee bank draft.

19. As held by the apex Court in case of Attar Singh Gurmukh Singh (supra). "...In our opinion, there is little merit in this contention. Sec. 40A(3) must not be read in isolation or to the exclusion of r. 6DD. The section must be read along with the rule. If read together, it will be clear that the provisions are not intended to restrict the business activities. There is no restriction on the assessee in his trading activities. Sec. 40A(3) only empowers the A.O. to disallow the deduction claimed as expenditure in respect of which payment is not made by crossed cheque or crossed bank draft. The payment by crossed cheque or crossed bank draft is insisted on to enable the assessing authority to ascertain whether the payment was genuine or whether it was out of the income from undisclosed sources. The terms of s. 40A(3) are not absolute. Considerations of business expediency and other relevant factors are not excluded. Genuine and bona fide transactions are not taken out of the sweep of the section. It is open to the

assessee to furnish to the satisfaction of the A.O. the circumstances under which the payment in the manner prescribed in s. 40A(3) was not practicable or would have caused genuine difficulty to the payee. It is also open to the assessee to identify the person who has received the cash payment. Rule 6DD provides that an assessee can be exempted from the requirement of payment by a crossed cheque or crossed bank draft in the circumstances specified under the rule. It will be clear from the provisions of s. 40A(3) and r. 6DD that they are intended to regulate business transactions and to prevent the use of unaccounted money or reduce the chances to use black money for business transactions."

20. It was because of these considerations that this Court in case of Hynoup Foods (P.) Ltd. (*supra*) observed that the genuineness of the payment and the identify of the payee are the first and foremost requirements to invoke the exceptions carved out in r. 6DD(j) of the IT Rules, 1962.

21. In the present case, neither the genuineness of the payment nor the identity of the payee were in any case doubted. These were the conclusions on facts drawn by the CIT(A). The Tribunal also did not disturb such facts but relied solely on r. 6DD(j) of the Rules to hold that since the case of the assessee did not fall under the said exclusion clause nor was covered under any of the clauses of r. 6DD, consequences envisaged in s. 40A(3) of the Act must follow.

22. In our opinion, the Tribunal committed an error in coming to such a conclusion. We would base our conclusions on the following reasons:

(a) The paramount consideration of s. 40A(3) is to curb and reduce the possibilities of black money transactions. As held by the Supreme Court in *Attar Singh Gurmukh Singh* (*supra*), s. 40A(3) of the Act does not eliminate considerations of business expediencies.

(b) In the present case, the appellant assessee was compelled to make cash payments on account of peculiar situation. Such situation was as follow--

(i) the principal company, to which the assessee was a distributor, insisted that cheque payment from a co-operative bank would not do, since the realization takes a longer time;

(ii) the assessee was, therefore, required to make cash payments only;

(iii) Tata Tele Services Ltd. assured the assessee that such amount shall be deposited in their bank account on behalf of the assessee;

(iv) It is not disputed that the Tata Tele Services Ltd. did not act on such promise;

(v) if the assessee had not made cash payment and relied on cheque payments alone, it would have received the recharge vouchers delayed by 4/5 days and thereby severely affecting its business operations.

We would find that the payments between the assessee and the Tata Tele Services Ltd. were genuine. The Tata Tele Services Ltd. had insisted that such

payments be made in cash, which Tata Tele Services Ltd. in turn assured and deposited the amount in a bank account. In the facts of the present case, rigors of s. 40A(3) of the Act must be lifted.

23. We notice that the Division Bench of the Rajasthan High Court in case of Smt. Harshila Chordia Vs. Income Tax Officer, had observed that the exceptions contained in r. 6DD are not exhaustive and that the said rule must be interpreted liberally.

24. Before closing, we may clarify that the above observations would apply only to the cash payments made by the assessee to the Tata Tele Services Ltd. No such peculiar facts arise in case of payments made to the other two agencies viz., Rajvi Enterprise and R.D. Infocom. Learned counsel for the appellant also clarified that this appeal is confined to only the payments made to Tata Tele Services Ltd. and no others. In the result, the question is answered in favour of the appellant assessee and against the Revenue. Judgment of the Tribunal is reversed. Tax appeal is allowed. Order accordingly.