
(2002) 12 KL CK 0056

In the High Court Of Kerala

Case No : O.P. No. 15819 of 1997 with O.P. No's. 3147, 21319, 25344, 25345, 25346 of 1998, 459, 684 and 1962 of 1999 20 December 2002

Kamath Marbles

APPELLANT

Vs

ITO and Others

RESPONDENT

Date of Decision : 20-12-2002

Acts Referred:

Constitution of India, 1950 — Article 14, 19
Income Tax Act, 1961 — Section 192, 40A

Citation : (2003) 260 ITR 470

Hon'ble Judges : C.N. Ramachandran Nair, J

Bench : Division Bench

Advocate : C. Kochunni Nair and Dale P. Kurian, for the Assessee P. K. R. Menon and N. R. K. Nair, for the Revenue, for the Appellant;

Judgement

C.N. Ramachandran Nair, J.

The petitioners in these original petitions are Income Tax assessee engaged in business. They are challenging the provisions of section 40A(3) of the Income Tax Act, 1961, which provides for 20 per cent disallowance of expenditure in excess of Rs. 20,000 where such payments are made other than through account payee cheques or demand drafts drawn on a bank. Section 40A(3) prior to its amendment with effect from 1-4-1997, provided for disallowance of entire expenditure subject to rule 6DD in excess of payments over Rs. 10,000 made other than through account payee cheques and demand drafts. However, until the amendment of rule 6DD(j) with effect from 1-12-1995, the assessing officer was free to allow deductions on cash payments in excess of Rs. 10,000 if he was satisfied that such payments are made in unavoidable circumstances or it was not practical to make payment other than through cash or payment through account payee cheques or demand drafts would have caused genuine difficulty to the payee having regard to the nature of the transaction and the necessity for expeditious settlement thereof and on production of proof in this regard. Consequent to the amendment of section 40A(3) and substitution of clause (j)

and addition of clauses (k) and (l) to rule 6DD, any assessee who does not satisfy the conditions laid down in clauses (h), (k) and (l) will be subject to disallowance at 20 per cent on the expenditure in excess of Rs. 20,000 which is not paid through account payee cheques or demand drafts. The petitioners, who are assessee engaged in business, are challenging the validity of section 40A(3) authorising disallowance to the extent of 20 per cent of the expenditure made in cash.

2. I heard Sri C. Kochunni Nair and Sri Premjit Negendran, learned counsel for the petitioners, and learned standing counsel for the respondents. The petitioners contend that the Supreme Court upheld the constitutional validity of section 40A(3) prior to its amendment, only by virtue of the then existing rule 6DD(j) of the Income Tax Rules which authorised the officer to allow the claim of expenditure made in cash over the limit prescribed in section 40A(3), if the officer was satisfied about the genuineness of payment. They further contend that the present provision authorising disallowance of 20 per cent of expenditure over Rs. 20,000 made other than through account payee cheque or demand draft after deletion of rule 6DD(j) as it stood prior to its substitution by the Income Tax (Twenty First Amendment) Rules, 1995 (see (1996) 217 ITR 2 , is arbitrary and violative of the petitioners rights under articles 14 and 19(1)(g) of the Constitution of India. Therefore, according to counsel, the decision of the Supreme Court in Attar Singh Gurmukh Singh v. ITO, (1991) 191 ITR 667 (SC) cannot be relied on by the department to sustain validity of the section as it stands now. Standing counsel for the department, on the other hand, contended that the Government of India has not deleted rule 6DD(j) as such but has reframed the entire rules among others introducing new provisions, namely, (k) and (l) along with substituted clause (j). According to him, the safeguards provided in rule 6DD after the amendment referred to above will cover all practical difficulties for businessmen. His further contention is that section 40A(3) does not affect the petitioners right to carry on business under article 19(1)(g) of the Constitution as the petitioners are only subject to a disability of 20 per cent disallowance if the expenditure is made in the form of payments in excess of Rs. 20,000 other than through account payee cheques or demand drafts except in cases covered by various clauses of rule 6DD. The petitioners contend that the department itself has recognised situations under rule 6DD where payments have to be made by people engaged in business other than through account payee cheque or demand draft above Rs. 20,000 and therefore disallowance of 20 per cent of the same is arbitrary. Their contention is that even without any proposal in the Finance Bill, 1996, the Minister on the basis of the representations from various trade organisations increased the limits of expenditure through cash other than through cheque or demand drafts from Rs. 10,000 to Rs. 20,000. Therefore, according to them, business exigencies which required payments in the form of cash is something accepted by the government and therefore there cannot be any further restriction in the form of disallowance of expenditure to the extent of 20 per cent in such cases.

3. It has to be noted that the Supreme Court has upheld the constitutional validity of section 40A(3) in *Attar Singh Gurmukh Singh v. ITO*, (1991) 191 ITR 667 (SC) referred to above. Of course, the Supreme Court was dealing with section 40A(3) prior to its amendment vide Finance (No. 2) Act, 1996, wherein the provision was for complete disallowance of expenditure if the same was in excess of the limit provided then u/s 40A(3) which was Rs. 10,000. While considering the validity of section 40A(3), the Supreme Court has also strongly relied on rule 6DD(j) as it stood then which is as follows :

"(j) in any other case, where the assessee satisfies the assessing officer that the payment could not be made by a crossed cheque drawn on a bank or by a crossed bank draft

(1) due to exceptional or unavoidable circumstances, or

(2) because payment in the manner aforesaid was not practicable, 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 also furnishes evidence to the satisfaction of the assessing officer as to the genuineness of the payment and the identity of the payee."

4. Now the rule is substituted. The rule with the clauses relevant for the purpose of the petitioners case is as follows :

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

(f) where the payment is made for the purchase of

(i) agriculture or forest produce; or

(ii) the produce of animal husbandry (including 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 or producer of such articles, produce or products;

(g) 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;

(h) 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;.

(j) 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

(A) 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

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

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

(l) 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."

5. In view of the above binding decision of the Supreme Court, the question now to be considered is whether the amendment to the Act and the Rules under challenge will make any change in the law as declared by the Supreme Court. In principle, the Supreme Court held that section 40A(3) does not violate article 14 or 19(1)(g) of the Constitution. Any restriction on expenditure in the Income Tax Act cannot be said to be violative of the petitioners right to carry on business and, therefore, the allegation of violation of articles 14 and 19(1)(g) of the Constitution is baseless. The Madras High Court in the decision reported in Dollar Co. Private Ltd. Vs. Union of India and others, , held that the ceiling refixed on expenditure by the Income Tax Act cannot be held to be unconstitutional. The court held that determination of taxable income is in accordance with the statute and the Legislature was free to put any ceiling on expenditure and the assessee has no other right to claim deduction of such expenditure unless the same is permissible by the statute. Standing counsel for the department argued that the Andhra Pradesh High Court in Ch. Mangayamma Vs. Union of India and others, , upheld the validity of section 40A(3) even after the amendment of the Act and the rules which is now under challenge in this court. It was held by the Andhra Pradesh High Court that the mere fact that the rule making authority did not retain the old rule, does not make the main section itself unconstitutional. Learned counsel for the petitioners, on the other hand, contended that the Andhra Pradesh High Court does not lay down the correct position of law, but relies on the decision of the Supreme Court whereunder section 40A(3) was upheld in view of the then prevailing rule 6DD(j). It has, therefore, to be examined as to the scope of the new rules which have come in the place of the earlier rule based on which the Supreme Court rendered its decision. Now even after the amendment to the rules by the Income Tax (Twenty First Amendment) Rules, 1995 and the Income Tax (Twenty Fourth Amendment) Rules (sic) there is a provision for complete deduction of expenditure over Rs. 20,000 incurred in cash under clause (f) of rule 6DD for payment made for the purchase of agricultural or forest produce or the produce of animal husbandry or dairy or poultry farming or fish or fish products or the products of horticulture or apiculture to the cultivator, grower or producer of such articles, produce or products. Similarly exemption is provided for payment on purchase of products

of cottage industry. Clause (h) of rule 6DD, specifically excludes payments made in cash from the scope of disallowance u/s 40A(3) where such payment is made in a village or town, which is not served by any bank or to any person who ordinarily resides or is carrying on any business in any such village or town. Clause (k) provides complete immunity from the restriction of section 40A(3) for payments in cash in excess of Rs. 20,000 made on a day on which the banks are closed either on account of holiday or strike. Lastly, clause (1) of rule 6DD provides that section 40A(3) does not apply to a case of payment made by a person to his agent who is required to make payment in cash for goods or services on behalf of such person. Relying on these clauses standing counsel for the department contended that the government has taken sufficient care to prescribe the rules under the proviso to rule 40A(3) to cover all cases where assesseees have genuine difficulty to pay through cheque or demand draft. I feel, clause (h) of rule 6DD read with clause (k) itself provides sufficient liberalisation of the rigour of section 40A(3) which entitles the parties to claim full deduction on cash payments over Rs. 20,000 where banking services are not available in the place where the expenditure is incurred or on the day the expenditure is incurred. In other words, the statute and the rules insist for payment through account payee cheques or demand drafts only in cases where banking services are available to the parties. It cannot be said that insistence of money transactions through the bank where the facilities are available which is to ensure transparency in the transactions any way affects the rights of the parties to carry on any trade or business. In fact I am of the view that clauses (h) and (k) of rule 6DD are sufficient liberalisation to get over the practical difficulties of section 40A(3) and clause (1) only provides a leverage to the unscrupulous to get over the discipline of section 40A(3) of the Act. In the circumstances, I do not think, the amendment to the rule any way changes the position declared by the Supreme Court and, therefore, the petitioners are not entitled to succeed in the challenge against the statute. Therefore, I agree with the decision of the Andhra Pradesh High Court referred to above that the amendment to the rule does not affect the validity of the statute sustained by the Supreme Court. Above all, section 40A(3) does not cause any restriction in regard to expenditure. The only limitation is that those who do not conform to the discipline introduced, that is payments over Rs. 20,000 other than through account payee cheques or drafts except in the justifiable circumstances provided under rule 6DD and the section itself, invite disallowance of 20 per cent thereof. The Income Tax Act contains various restrictions and conditions for deductions and allowances which have been upheld by several High Courts and the Supreme Court on various occasions. The decision of the Madras High Court referred to above is one such decision on the ceiling of disallowance in respect of expenditure in the form of advertisement. The computation of income has to be therefore subject to statutory provisions and Parliament is absolutely competent to fix ceiling on expenditure and lay down conditions for allowance. Therefore, I do not find any merit in the contentions raised by the petitioners and the original petitions are accordingly dismissed.

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