
(1975) 02 KL CK 0002
In the High Court Of Kerala
Case No : Income Tax R. No. 68 of 1973

P.R. Textiles

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 19-02-1975

Acts Referred:

Income Tax Act, 1961 — Section 14, 40A, 40A(3)
United Kingdom Income Tax Act, 1952 — Section 137

Citation : (1980) 121 ITR 237

Hon'ble Judges : P. Govindan Nair, C.J.;V. Khalid, J

Bench : Division Bench

Judgement

Govindan Nair, C.J.—The Income Tax Appellate Tribunal, Cochin Bench, has stated a case and referred the following question to the High Court for its opinion :

"Whether the payment of Rs. 40,840 in cash made up of Rs. 4,000 paid by the appellant to M/s. K.N.G. Brothers, Ernakulam, and Rs. 36,840 paid to M/s. Neelakanta Iyer, Vaikom, for purchase of textiles is "expenditure" liable to be disallowed u/s 40A(3) of the Income Tax Act, 1961?"

2. For the assessment year 1970-71, M/s. P. R. Textiles, Thodupuzha, a registered firm for the purpose of the I.T. Act, 1961, filed a return disclosing an income of Rs. 12,835. While examining the accounts of the assessee, the ITO found that the assessee had paid in cash to M/s. K.N.G. Brothers, Ernakulam, Rs. 4,000 on June 6, 1969, and to M/s. Neelakanta Iyer, Vaikom, Rs. 36,840 on various dates in cash towards the sale consideration for the purchase of textile goods. According to the ITO the above sums represented "expenditure" falling within the expression "any expenditure" occurring in Section 40A(3) of the I.T. Act, 1961, and the above sums were disallowed as items of expenditure and the income of the assessee was determined as Rs. 53,725. The assessee's appeal before the AAC was dismissed and his further appeal before the Income Tax Appellate Tribunal was also dismissed though the Judicial Member had differed

from the Accountant Member and held in favour of the assessee. The third member to whom the case was referred by the Chairman agreed with the Accountant Member and the appeal was, therefore, dismissed.

3. Learned counsel, Sri C. K. Viswanatha Iyer, who argued the case before us on behalf of the assessee did not press his arguments on the basis of the reasoning adopted by the Judicial Member who dissented from the other member. He contended that in a trading business such as that carried on by the assessee, amounts will have to be spent for purchasing the goods which were dealt with by the assessee by way of sale and what is paid towards sale consideration of such goods did not amount to expenditure and that in a commercial sense such payments must be taken to be outside the purview of the expression "expenditure". Such payments, counsel contended, had to be reckoned for arriving at the gross profit as distinct from the "net profit". It was argued that the restriction in Section 40A(3) will apply only to such expenditure which had to be met from the gross profit arrived at after deducting from the cost price of goods sold by the assessee carrying on the business of purchase and sale, the purchase price. No direct authority for this proposition had been cited before us. Counsel referred to the decisions in *Navnitlal C. Javeri Vs. K.K. Sen*, Appellate Assistant Commissioner of Income Tax, "D" Range, Bombay, and in *Indian Molasses Co. (Private) Ltd. Vs. Commissioner of Income Tax, West Bengal*, . We do not find these decisions helpful for the purpose of determining the question before us.

4. Section 40A briefly stated deals with expenses or payments not deductible in certain circumstances and the provisions of the section shall have effect notwithstanding anything to the contrary contained in any other provision of the Act relating to the computation of income under the head "Profits and gains of business or profession". This section occurs among the group of sections starting with Section 14 in Chap. IV dealing with computation of total income under the various heads of income and relates to the 4th mentioned head "Profits and gains of business or profession". Section 40A will have to be applied in computing the total income of the assessee, there can be no dispute. Sub-section (3) of Section 40A is in these terms :

"Where the assessee incurs any expenditure in respect of which payment is made, after such date (not being later than the 31st day of March, 1969) as may be specified in this behalf by the Central Government by notification in the Official Gazette, in a sum exceeding two thousand five hundred rupees otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, such expenditure shall not be allowed as a deduction....."

5. The proviso to the sub-section is not material. A plain reading of the section is certainly capable of giving the sense that any amounts expended by an assessee exceeding the sum of Rs. 2,500 unless the payment had been made in the manner provided in the sub-section, shall not be deducted in computing the assessee's total income arising from profits and gains of business or profession.

In this connection it need hardly be emphasised that the words used in the sub-section are "any expenditure". The meaning of the word "expenditure", though in another connection, was referred to by the Supreme Court in *Indian Molasses Co. (Private) Ltd. Vs. Commissioner of Income Tax, West Bengal*, their Lordships observed:

" "Spending" in the sense of "paying out or away" of money is the primary meaning of "expenditure". "Expenditure" is what is paid out or away and is something which is gone irretrievably. Expenditure, which is deductible for Income Tax purposes, is one which is towards a liability actually existing at the time, but the putting aside of money which may become expenditure on the happening of an event is not expenditure."

6. Money has actually been given away no doubt towards the cost of the material purchased is admitted. So, if the ordinary meaning of the expression of the word "expenditure" is applied, Section 40A(3) would prevent reckoning of expenditure over Rs. 2,500 unless the payment was in the manner provided by the sub-section. The normal rule in interpreting any statute or any section of a statute and this is the rule that must be applied is that the expressions used in the statute or the section must be understood in its normal literal grammatical sense. There is no compelling feature, such as literal grammatical sense or even an anomaly being created by understanding the words in their usual sense. Counsel for the assessee suggested that if the amounts expended towards the purchase of goods dealt with by an assessee are not permitted to be deducted, the tax on profits and gains of business or profession would become a tax not on "income" but on gross receipts of sales. There is no challenge about the validity of Section 40A(3) in that its powers are beyond the legislative competence of Parliament. So, we have to understand the section as it stands and apply it. No doubt in interpreting the section we will give it a meaning which would make the section constitutional, i.e., we would avoid placing on it an interpretation which would make it unconstitutional. We are not at all satisfied that understanding the section according to the ordinary meaning of the words used in the section would make the section unconstitutional. Batliboi in his *Advanced Accounting* at page 51 has given the form of a trading account which runs thus:

" Form of trading account

Rs.

Rs.

To stock at a commencement

By sales

" purchase less returns

less

" Freight, duty etc.

returns

" Carriage inward

" Gross profit transferred to P/L A/c.

Rs.

Rs. "

7. Herein we find on the left hand side the expression "Gross profit transferred to profit and loss account". It is evident from the form that gross profits are arrived at by deducting from what has been received by sales less returns the amounts expended towards purchase and other allied items of expenditure. It may be that, if it is the above form adopted in accounting that gave encouragement to counsel for raising the contention that unless the amounts expended towards the purchase of goods dealt with by an assessee doing the business of buying and selling are allowed to be deducted for ascertaining the gross profits and other items of expenditure deducted from such gross profits for arriving at the net income, tax imposed would be not on income but on gross receipts. We are not concerned with this aspect as the section has not been challenged. The only question before us is whether in determining the quantum of the profits and gains of the business of the assessee, the payments of sums above Rs. 2,500 made by the assessee otherwise than by crossed cheque should be disallowed. The House of Lords had to deal with a similar question in interpreting Section 137 of the U.K. Income Tax Act, 1952. We shall extract the relevant part of the section, which is Clause (1) of Section 137 :

"Subject to the provisions of this Act, in computing the amount of the profits or gains to be charged under Case I or Case II of Schedule D, no sum shall be deducted in respect of--...

(1) any annual interest or any annuity or other annual payment payable out of the profits or gains."

8. Lord Halsbury in *Gresham Life Assurance Society v. Styles* [1892] AC 309 observed as follows :

"Now, if I understood the contention before your Lordships aright, it rested on the fourth rule relating to assessment under Schedule D which prohibited any deduction being made on account of any annual interest or any annuity or any other annual payment, and as those sums were annuities or annual payments it was said that they were not to be deducted in estimating the amount of the profits and gains arising as aforesaid. And if the rule had stopped at the point up to which I have quoted it I should have concurred with the contention of the surveyor. But the rule does not stop there. In order to be a prohibited reduction it must be sought to be made on an annuity or other annual payment payable "out of such profits or gains"."

9. The underlining is ours and the portion underlined indicates that if there had

not been the words "out of such profits or gains" occurring in the section, such payments would not have been taken into account in computing the income.

10. We have to understand Section 40A(3) in the same manner. The amounts in question cannot be taken into account in computing the profits and gains.

11. We answer the question referred to us in the affirmative, that is, in favour of the department and against the assessee. We direct the parties to bear their respective costs,

12. A copy of this judgment under the seal of the High Court and the signature of the Registrar will be forwarded to the Income Tax Appellate Tribunal, Cochin Bench.