

(1975) 11 AHC CK 0022

In the Allahabad High Court

Case No : Income-tax Reference No. 712 of 1973

U.P. Hardware Store

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 11-11-1975

Acts Referred:

Income Tax Act, 1961 — Section 28, 30, 31, 32, 33
Income Tax Rules, 1962 — Rule 6DD

Citation : (1976) 104 ITR 664

Hon'ble Judges : R.L. Gulati, J;C.S.P. Singh, J

Bench : Division Bench

Advocate : R.R. Agarwal and Bharatji Agarwal, for the Appellant; Deokinandan, for the Respondent

Final Decision : Dismissed

Judgement

R.L. Gulati, J.—This is a reference u/s 256(1) of the Income Tax Act, 1961.

2. The assessee is a registered firm carrying on the business of iron and hardware. The proceedings relate to the assessment year 1970-71. During the course of examination of the books of accounts of the assessee, the Income Tax Officer discovered that the assessee had made payments in cash exceeding the sum of Rs. 2,500 for some of the purchases. The total of such payments came to Rs. 55,471. Being of the view that u/s 40A(3) read with Rule 6DD of the Income Tax Rules, 1962, such payments could not be allowed as deduction, the Income Tax Officer required the assessee to show cause why the payments amounting to Rs. 55,471 be not disallowed. After considering the explanation filed by the assessee, the Income Tax Officer came to the conclusion that the conditions laid down in Rule 6DD were not satisfied and he accordingly disallowed the sum of Rs. 55,471 claimed as deduction and added it to the income of the assessee. The assessee's appeal was dismissed by the Appellate Assistant Commissioner of Income Tax and its second appeal was also dismissed by the Income Tax Appellate Tribunal. However, at the instance of the assessee, the Tribunal has

referred the following two questions of law for the opinion of this court:

"(1) Whether, on the facts and in the circumstances of the case, the payments made to suppliers for purchase of goods are "expenditure" within the meaning of the Income Tax Act, 1961 ?

(2) If the answer to the first question is in the affirmative, whether the Tribunal was justified in maintaining the disallowance and/or addition of Rs. 55,741 in computing the taxable income of the assessee for the assessment year 1970-71 ?"

3. Section 40A was added to the Income Tax Act by Section 7 of the Finance Act of 1968, with effect from 1st April, 1968. We are concerned with the interpretation of Sub-section (3) of this section which reads:

"40A. (3) 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."

4. Sub-section (1) of Section 40A provides that the provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provision of this Act relating to the computation of income under the head "Profits and gains of business or profession".

5. Clearly, any expenditure incurred by an assessee in a sum of Rs. 2,500 or above is not to be allowed as a deduction unless the payment is made by a crossed cheque or a crossed bank draft. In other words, payments made in cash are to be disallowed. Now, in the instant case, there is no dispute that the assessee made payments exceeding Rs. 2,500 in cash and the total of such payment comes to Rs. 55,741. The only argument raised by the learned counsel for the assessee is that the payments made for purchase of stock-in-trade cannot be called "expenditure" and, as such, Section 40A(3) is not applicable. According to the learned counsel, the word "expenditure" must be restricted to expenditure which is allowed as a deduction under Sections 30 to 43A of the Act and the payments made for the purchase of stock-in-trade is not covered by any of these provisions.

6. Section 28 deals with the profits and gains of business or profession and by virtue of Section 29, the income referred to in Section 28 would be computed in accordance with the provisions contained in Sections 30 to 43A. The deductions contained in Sections 30 to 43A are overhead expenses such as rent, taxes, repairs, insurance, salary, etc., etc., and depreciation allowance. They are to be deducted out of the gross profits arising from the business and it is only then that the net profits are arrived at which are liable to tax. But we see no justification for accepting the plea that the word "expenditure" used in Section

40A(3) should be restricted to overhead expenses enumerated in Sections 30 to 43A, including the depreciation allowance, etc. The word "expenditure" is of wide import. It will also cover the expenses to be taken into account while determining the gross profit. The gross profit is determined by the difference between the opening stock and the purchases on the one side and the closing stock and the sales on the other. The payments made for purchases would also be covered by the word "expenditure" and such payments can be disallowed if they are made in cash in the sums exceeding Rs. 2,500. Such disallowance will increase the gross profit and would necessarily increase the net profit.

7. In enacting Section 40A(3) the intention of Parliament clearly was to prevent use of unaccounted money in carrying on business. Unaccounted money may be used in the purchases of stock-in-trade or raw materials or in payment of overhead expenses, We will be defeating the intention of the legislature if we restrict the import of the word "expenditure" to merely overhead expenses and do not take into account the expenditure incurred on the purchases of stock-in-trade or raw materials. In *Mudiam Oil Co. and Others Vs. Income Tax Officer and Others*, the Andhra Pradesh High Court has upheld the validity of Section 40A(3) on the ground that it was only to regulate the business activities and prevent unaccounted money being used for clandestine transactions and it was in the interest of revenue and national economy that the restrictions have been imposed.

8. It is now well settled that the list of allowances enumerated in Sections 30 to 43A is not exhaustive and an item of loss or expenditure incidental to business may be deducted in computing "profits and gains" even if it does not fall within any of these sections, for the tax is on the true "profits and gains" properly so called and computed on ordinary commercial principles. In *Commissioner of Income Tax v. S. M. Chitnavis* [1932] 2 Comp Cas 464 6 ITC 453 a bad debt was held to be an admissible deduction, though there was no specific allowance for bad debts in the Indian Income Tax Act, 1922, as it then stood. Lord Russell, delivering the judgment of the Board, said :

"Although the Act nowhere in terms authorises the deduction of bad debts of a business, such a deduction is necessarily allowable. What are chargeable to Income Tax in respect of a business are the profits and gains of a year and in assessing the amount of the profits and gains of a year account must necessarily be taken of all losses incurred, otherwise you would not arrive at the true profits and gains."

9. In *Badridas Daga Vs. The Commissioner of Income Tax*, and in *Calcutta Company Ltd. Vs. The Commissioner of Income Tax, West Bengal*, , the Supreme Court quoted the observations of Lord Russell with approval and held that an item of loss or expenditure not falling within any of the express deductions may be allowed, if it is deductible on ordinary principles of commercial accounting.

10. The learned counsel then urged that money spent on purchase of stock-in-

trade, etc., represents circulating capital and cannot be included in the term "expenditure" which means money spent away. He cited certain cases to support this contention. It is not necessary to notice these cases because it cannot be disputed that the money invested in the purchases of stock-in-trade and raw materials represents circulating capital and such payments are not covered by any of the provisions contained in Sections 30 to 43A. But the value of the stock-in-trade has to be taken into account while determining the gross profits u/s 28 itself on principles of commercial accounting.

11. It is no doubt true that the provisions contained in Sections 30 to 43A some time may cause undue hardship to an assessee inasmuch as he might have to make purchases from a place where no banking facility is available or from a person who does not maintain a bank account or he might have to make payments to certain institutions like banks, etc., which can easily be verified. In order to mitigate such hardships the Central Board of Direct Taxes has framed Rule 6DD which provides for cases and circumstances in which payments exceeding the sum of Rs. 2,500 may be made otherwise than by a crossed cheque or a crossed bank draft. This rule provides that no disallowance under Sub-section (3) of Section 40A shall be made where any payment in a sum exceeding two thousand five hundred 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) agricultural 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;

(i) where any payment by way of gratuity, retrenchment compensation or similar terminal benefit, is made to an employee of the assessee or the heirs of any such employee on or in connection with the retrenchment, resignation, discharge or death of such employee, if the income chargeable under the head "Salaries" of the employee in respect of the financial year in which such retirement, resignation, discharge or death took place or the immediately preceding financial year did not exceed Rs. 7,500 ;

(j) in any other case, where the assessee satisfies the Income Tax Officer that the payment could not be made by a crossed cheque drawn on a bank or by a crossed bank draft due to exceptional or unavoidable circumstances and also furnishes evidence to the satisfaction of the Income Tax Officer as to the genuineness of the payment and the identity of the payee." Rule 6DD clearly contemplates payments made for stock-in-trade and raw materials. This rule is in accordance with the intention of Parliament as contained in Section 40A(3). The rule provides that an assessee can be exempted from the requirements of payment by a crossed cheque or a bank draft where the purchases are made of certain agricultural or horticultural commodities or from a village where there is no banking facility. It also provides for the cases where an assessee is able to satisfy the Income Tax Officer that due to exceptional and unavoidable circumstances, payment could not be made by cheque, etc., and also furnishes evidence to the satisfaction of the Income Tax Officer as to the genuineness of the payments and the identity of the payee. It has been found in the instant case that the assessee's case was not covered by any of the exceptions provided under Rule 6DD and, as such, the disallowance was proper.

12. We, accordingly, answer both the questions in the affirmative, in favour of the department and against the assessee. The department is entitled to costs, which we assess at Rs. 200.