IN THE INCOME TAX APPELLATE TRIBUNAL, GUWAHATI BENCH, GUWAHATI
VIRTUAL HEARING AT KOLKATA

BEFORE SHRI RAJESH KUMAR, HON'BLE ACCOUNTANT MEMBER
AND SHRI SONJOY SARMA, HON'BLE JUDICIAL MEMBER

ITA No. 102/GTY/2020
Assessment Year: 2017-18

Jyoti Prakash Das Kumud Enclave, Nawaram Kakati Path, Rehabari, Guwahati-781008. **PAN: AJIPD 5193 Q**	Vs.	DCIT, Circle-3, Guwahati
(Appellant)		(Respondent)

Present for:
Appellant by : Shri Ramesh Goenka, Advocate
Respondent by : Shri Arun Bhowmick, JCIT

Date of Hearing : 31.08.2023
Date of Pronouncement : 31.08.2023

O R D E R

PER SONJOY SARMA, JM:

The present appeal has been preferred by the assessee against the order dated 07.02.2020 of ld. CIT(A), Guwahati-2 passed u/s 250 of the Income Tax Act [hereinafter referred to as the 'Act']. The assessee has raised the following grounds of appeal:

"1(a). That neither the learned assessing officer was justified in making disallowance of Rs. 1,43,73,603/- on account of proportionate direct expenses and adding the same in the closing stock of the appellant nor the learned CIT(A) was justified in confirming the aforesaid disallowance/addition.

1(b). That both the learned AO as well as the learned CIT(A) erred in law as well as on facts in ignoring the method of accounting regularly followed by the appellant and accepted by the revenue.

2. That neither the learned assessing officer was justified in disallowing Rs. 18,16,738/- u/s 40A(3) of the Income Tax Act, 1961 nor the learned CIT(A) was justified in confirming the disallowance.

3. That the appellant craves leave to submit any other ground/s on or before the hearing of the appeal."

2. Brief facts of the case are that the assessee filed its return of income for the assessment year 2017-18 by showing income at Rs. 21,51,230/-. Subsequently, the case of the assessee was selected for scrutiny through CASS followed by notices issued u/s 143(2) and 142(1) of the Act along with detailed questionnaire. In response to the notices, the ld. AR of the assessee appeared before the AO time to time and furnished necessary submission before him in compliance to such notices. The ld. AO after considering the submission of the assessee, he made an addition u/s 69C of the Act of Rs. 25,25,440/- and another sum of Rs. 18,16,736/- u/s 40A(3) of the Act. In addition to that further assessee have shown of Rs. 8,24,75,731/- as closing stock and according to ld. AO it was not correct figure and disallowed a sum of Rs. 1,43,73,603/-, out of Rs. 2,76,11,380/- towards direct expenses in the hands of assessee.

3. Dissatisfied with the above, assessee preferred an appeal before the ld. CIT(A) where the appeal of the assessee was partly allowed.

4. Aggrieved by the above order assessee is in appeal before the Tribunal raising various grounds of appeal for adjudication.

5. The first issue raised by the assessee vide Ground Nos. 1(a) and 1(b)relates to disallowance of Rs.1,43,73,603/- made by the AO on account of proportionate direct expenses by making an addition in the closing stock of the assessee which was confirmed by the ld. CIT(A).

6. On this issue, the ld. A/R submitted before us that for AY 2016-17, the ld. AO was satisfied on the same valuation and method adopted by the assessee for valuation of the closing stock on 31/03/2016, as adopted by the assessee in the impugned assessment year. However, without giving any specific reason, the ld. AO by rejecting the same method of valuation of closing stock applied by the assessee for AY 2017-18, is not in accordance with law and liable to be set aside by the Tribunal. He further contended that the assessee has submitted the value -wise closing stock of each project containing, measurements, cost of materials, cost of labour etc., at the time of hearing before the AO, however, while framing the assessment order the ld. AO has rejected the same and added the sum of Rs.1,43,73,603/- on estimate basis. The ld. A/R further contended that if assessee's closing stock as on 31/03/2016, was accepted as correct then it is naturally becomes the opening balance in FY 2016-17 relating to AY 2017-18 and assessee has submitted all the ledger accounts under direct expenses before the AO, who has not raised any objection in this regard. Besides that, the AO has not any objection with regard to the sales figure shown by the assessee for AY 2017-18. Therefore, the view taken by the authorities below while making an addition of Rs.1,43,73,603/- on estimate basis in the hands of the assessee is not justified.

6.1. The ld. A/R in order to substantiated his claim by placing before us a paper book wherein at page 71, produced a comparative chart showing sales/turnover, GP and NP of the assessee for AY 2014-15, 2015-16 and 2016-17 respectively and submitted that if the addition is sustained in the hands of the assessee, the NP result will be arrived at 46.82%, which would be far more than the result of NP declared by the assessee for AY 2014-15 and 2015-16. Therefore,

he prayed that the Tribunal may set aside the order passed by the authorities below and sustain the Net profit declared by the assessee, since for AY 2016-17, the ld. AO accepted the valuation method adopted by the assessee.

7. On the other hand, the ld. D/R relied on the orders of the authorities below.

8. After hearing the rival submissions and carefully perusing the material available on record, we notice that for AY 2016-17, method of valuation of stock applied by the assessee has been accepted by the AO and in the impugned AY in question, the closing stock for AY 2016-17 shall be termed as opening stock for AY 2017-18. Therefore, the AO cannot take two views regarding valuation of stock. When he accepted the opening balance declared by the assessee as correct by accepting the method of stock valuation adopted by the assessee for AY 2016-17, but he did not agree to accept the closing stock and valuation method adopted by the assessee. Moreover, while doing so he even did not reject the books of account maintained by the assessee and similarly he failed to raise any objection regarding the sales figures declared by the assessee. Under these given facts and circumstances, we are not in consonance with the view taken by the ld. CIT(A) while sustaining the addition made by the AO and in view of the above fact, we set aside the impugned order passed by the ld. CIT(A) by deleting the addition made in the hands of the assessee of Rs.1,43,73,603/-. Accordingly, Ground No. 1 (a) & 1(b), raised by the assessee are allowed.

9. Ground No. 2 raised by the assessee relates to the confirmation of disallowance of Rs.18,16,738/- made by the AO u/s 40A(3) of the Act.

10. The ld. A/R submitted that assessee has undertaken various casting jobs and for which assessee has required raw materials such as stones, chips, boulders and sand for completion of the work undertaken due to the reasons that most of the suppliers run their business on cash basis and these suppliers do not fall under the iota of Income Tax Act as those were claiming exemptions u/s 10(26) of the Act. Besides that in order to substantiate his claim, the ld. A/R relied on the decision rendered by the Hon'ble Jurisdictional High Court in the case of *Walford Transport (Eastern India) vs. Commissioner Of Income*in *1999 240 ITR 902 Gauhati,* wherein Hon'ble High Court while explaining section 40A(3) of the Act, the Hon'ble Court held that the whole objective of the said section was not to penalize the assessee for making Cash payment but to check the evasion of tax and the trail of unaccounted money or check the transactions which are not genuine whereas in the instant case the assessee has paid such amounts to various parties to expedite the process of supply of raw materials and most of the suppliers delivered goods on cash basis and were claiming exemption u/s 10(26) of the Act. He further submitted that since the genuineness of the payments have not been doubted by the authorities below, therefore, the claim of the assessee for such business expediency, such amount should not be disallowed. The ld. A/R prayed that the disallowance made by the ld. AO may be deleted.

11. The ld. D/R on the other hand vehemently argued supporting the orders of the lower authorities.

12. We after hearing the rival contentions of the parties, notes from the details and documents submitted by the assessee during the course of assessment proceedings that the assessee has incurred expenditure in excess of Rs.20,000/- by cash. The details of same are noted in the assessment order for a sum of Rs.18,16,738/-. The ld. A.O. while framing the assessment order accordingly disallowed the same. Aggrieved assessee preferred appeal before the ld. CIT(A), wherein, the ld. CIT(A) held that the assessee has failed to furnish any conclusive evidence or explanation to substantiate his claim that the alleged cash payments fall within the exclusions provided under Rule 6DD(k) of the Income Tax Rules, 1962, and confirmed the disallowance made by the Assessing Officer.

13. While we looking into Section 40A(3) of the Act has a direct bearing on the instant case, the same is reproduced for ready reference:-

> *"(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, exceeds twenty thousand rupees, no deduction shall be allowed in respect of such expenditure.*
> *(3A) 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 payment or aggregate of payments made to a person in a day, 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 sub-section (3) and this sub-section 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 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.".***

{emphasis ours}

14. Be that as it may, even though Rule 6DD of I.T. Rules carves out the exceptions, but in Section 40A(3) of the I.T. Act, 1961 itself, an exception is provided i.e., on account of nature and extent of banking facilities available, consideration of business expediency and other relevant factors. It is not in dispute that assessee was engaged in the business of contractual construction work. The amounts in question have been tabulated in the assessment order. These payments have been made towards procuring raw materials for construction. Now, the ld. Counsel for the assessee has submitted that these payments were made to obtain stones/chips/boulder and sand for earth filling job. The payments were made to outside supplier who run their business on cash basis and don't believe in banking system. The nature of business of the assessee clearly shows that for business expediency in the line of business, sometimes cash payments are required to complete the work on behalf of Principal. The assessee, under such compelling reasons, shall have to make payments in cash on account of urgent need of getting the work executed. The authorities below have not doubted the identity of the payee and the genuineness of the transaction in the matter. The source of payment is also not been doubted by the authorities below.

15. ITAT, 'B' Bench, Kolkata vide Order dated 18.11.2015 passed in *ITA No. 1448/Kol/2011 AY 2008-09* in the case of *Sri Manoranjan Raha vs. ITO* under identical circumstances, held as under:-

> *"4.3 We have heard the rival submissions and perused the materials available on record. We find that the payments made by cash in violation of Section 40A(3) of the Act have been duly acknowledged by the recipient Sh. Amit Dutta who had deposed before the Ld. AO and confirmed the fact of receipt of monies in*

cash. Hence the genuinity of payments made by the assessee stands clearly established beyond doubt. Even for the amounts enhanced by Ld. CIT(A) in the sum of Rs. 54,01,473/-, the genuineness of the payments and the necessity to incur the said expenditure for the purpose of business of the assesseee was never disputed by the Ld. CIT(A). We hold that since the genuinity of the payments made to the parties is not doubted by the revenue, the provisions of section 40A(3) could not be made applicable to the facts of the instant case. It will be pertinent to go into the intention behind introduction of provisions of section40A(3) of the Act at this juncture. We find that the said provision was inserted by Finance Act 1968 with the object of curbing expenditure in cash and to counter tax evasion. The CBDT Circular No. 6P dated 6.7.1968 reiterates this view that "this provision is designed to counter evasion of a tax through claims for expenditure shown to have been incurred in cash with a view to frustrating proper investigation by the department as to the identity of the payee and reasonableness of the payment."

4.4. In this regard, it is pertinent to get into the following decisions on the impugned subject:-

Attar Singh Gurmukh Singh vs. ITO reported in (1991) 191ITR 667 (SC)
"Section 40A(3) of the Income-tax Act, 1961, which provides that expenditure in excess of Rs.2,500 (Rs.10,000/- after the 1987 amendment) would be allowed to be deducted only if made by a crossed cheque or crossed bank draft (except in specified cases) is not arbitrary and does not amount to a restriction on the fundamental right to carry on business. If read together with Rule 6DD of the Income-tax Rules, 1962,it will be clear that the provisions are not intended to restrict business activities. There is no restriction on the assessee in his trading activities. Section 40A(3) only empowers the Assessing Officer 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 upon to enable the assessing authority to ascertain whether the payment was genuine or whether it was out of income from undisclosed sources. The terms of section 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. 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 in section 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 thecircumstances specified under the rule. It will be clear from the provisions of section 40A(3) and rule 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."

CIT vs CPL Tannery reported in (2009) 318ITR 179 (Cal)

The second contention of the assessee that owing to business expediency, obligation and exigency, the assessee had to make cash payment for purchase of goods so essential for carrying on of his business, was also not disputed by the AO. The genuinity of transactions, rate of gross profit or the fact that the bonafide of the assessee that payments are made to producers of hides and skin are also neither doubted nor disputed by the AO, On the basis of these facts it is not justified on the part of the AO to disallow 20% of the payments made u/s 40A(3) in the process of assessment.

We, therefore, delete the addition of Rs.17,90,571/- and ground no.1 is decided in favour of the assessee.

CIT vs Crescent Export Syndicate in ITA No. 202 of 2008 dated 30.7.2008 - Jurisdictional High Court decision.

"It also appears that the purchases have been held to be genuine by the learned CIT(Appeal) but the learned CIT(Appeal) has invoked Section 40A(3) for payment exceeding Rs.20,000/- since it is not made by crossedcheque or bank draft but by hearer cheques and has computed the payments falling under provisions to Section 40A(3) for Rs.78,45,580/- and disallowed @20% thereon Rs.15,69,116/-. It is also made clear that without the payment being made by beater cheque these goods could not have been procured and it would have hampered the supply of goods within the stipulated time. Therefore, the genuineness of the purchase has been accepted by the ld. CIT(Appeal) which has also not been disputed by the department as it appears from the order so passed by the learned Tribunal. It further appears from the assessment order that neither the Assessing

Officer nor the CIT(Appeal) has disbelieved the genuineness of the transaction. There was no dispute that the purchases were genuine."

Anupam Tete Services vs ITO in (2014) 43 Taxmann.com 199 (Guj):

"Section 40A(3) of the Income-tax Act, 1961, read with rule 6DD of the Income-tax Rules, 1962 - Business disallowance - Cash payment exceeding prescribed limits (Rule 6DD(j)-Assessment year 2006- 07 - Assessee was working as an agent of Tata Tele Services Limited for distributing mobile cards and recharge vouchers - Principal company Tata insisted that cheque payment from assessee's co-operative bank would not do, since realization took longer time and such payments should be made only in cash in their bank account -If assessee would not make cash payment and make cheque payments alone, it would have received recharge vouchers delayed by 4/5 days which would severely affect its business operation - Assessee, therefore, made cash payment - Whether in view of above, no disallowance under section 40A (3) was to be made in respect of payment made to principal- Held, yes [Paras 21 to 23] [in favour of the assesse]"

Sri Laxmi Satvanaravana Oil Mill vs CIT reported in (2014) 49 taxmann.com 363 (Andhrapradesh High Court)

"Section 40A(3) of the Income-tax Act, 1961, read with Rule 6DD of the Income-tax Rules, 1962 - Business disallowance - Cash payment exceeding prescribed limit (Rule 6DD) - Assessee made certain payment of purchase of ground nut in cash exceeding prescribed limit - Assessee submitted that her made payment in cash because seller insisted on that and also gave incentives and discounts - Further, seller also issued certificate in support of this - Whether since assessee had placed proof of payment of consideration for its transaction to seller, and later admitted payment and there was no doubt about genuineness of payment, no disallowance could be made under section 40A(3) - Held, yes [Para 23] [In favour of the assessee]"

CIT vs Smt. Shelly Passi reported in (2013) 350 ITR 227 (P&H)

In this case the court upheld the view of the tribunal in not applying section 40A(3) of the Act to the cash payments when

ultimately, such amounts were deposited in the bank by the payee.

4.5 It is pertinent to note that the primary object of enacting section 40A(3) was two fold, firstly, putting a check on trading transactions with a mind to evade the liability to tax on income earned out of such transaction and, secondly, to inculcate the banking habits amongst the business community. Apparently, this provision was directly related to curb the evasion of tax and inculcating the banking habits. Therefore, the consequence, which were to befall on account of non- observation of section 40A(3) must have nexus to the failure of such object. Therefore, the genuineness of the transactions it being free from vice of any device of evasion of tax is relevant consideration.

4.6 The Hon'ble Apex Court in the case of CIT vs Swastik Roadways reported in (2004) 3 SCC 640 had held that the consequences of non-compliance of Madhya Pradesh Sales Tax Act , which were intended to check the evasion and avoidance of sales tax were significantly harsh. The court while upholding the constitutional validity negated the existence of a mens rea as a condition necessary for levy of penalty for non- compliance with such technical provisions required held that "in the consequence to follow there must be nexus between the consequence that befall for non- compliance with such provisions intended for preventing the tax evasion with the object of provision before the consequence can be inflicted upon the defaulter." The Supreme Court has opined that the existence of nexus between the tax evasion by the owner of the goods and the failure of C & F agent to furnish information required by the Commissioner is implicit in section 57(2) and the assessing authority concerned has to necessarily record a finding to this effect before levying penalty u/s. 57(2).

Though in the instant case, the issue involved is not with regard to the levy of penalty, but the requirement of law to be followed by the assessee was of as technical nature as was in the case of Swastik Roadways (3 SCC 640) and the consequence to fall for failure to observe such norms in the present case are much higher than which were prescribed under the Madhya Pradesh Sales Tax Act. Apparently, it is a relevant consideration for the assessing authority under the Income Tax Act that before invoking the provisions of section 40A(3) in the light of Rule 6DD as clarified by the Circular of the CBDT that whether the failure on the part of the assessee in adhering to requirement of

provisions of section 40A(3) has any such nexus which defeats the object of provision so as to invite such a consequence. We hold that the purpose of section 40A(3) 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 transaction. Admittedly, this is not the case in the facts of the assessee herein. The payments made in cash to Shri. Amit Dutta had been duly acknowledged by him in an independent deposition given by him before the Learned AO which was admittedly taken behind the back of the assessee. It is also pertinent to note that the Hon'ble Rajasthan High Court in the case of Smt. Harshila Chordia vs ITO reported in (2008) 298 ITR 349 (Raj) had held that the exceptions contained in Rule 6DD of Income Tax Rules are not exhaustive and that the said rule must be interpreted liberally.

4.7. The assessee has also given the income tax assessment particulars of Amit Dutta before the Learned AO. Moreover, the Learned AO himself had taken deposition from Sri Amit Dutta u/s 131 of the Act wherein he had confirmed the receipt of monies in cash as well as by cheque / DD from the assessee. Hence the acknowledgement of the payments made by the assessee by the payee is proved beyond doubt. The assessee had also stated that the payee had duly included these payments as his receipts in his returns.

4.8. We are unable to buy the argument of the Learned AR that the assessee had made payment tohis agent Mr.Arnit Dutta for purchase of sim cards and others and hence would fall under the exception provided in Rule 6DD(k) of the IT Rules. For the sake of convenience, Rule 6DD(k) is reproduced herein below:-

"Rule 6DD(k) of the IT Rules 1962 6DD. No disallowance under sub-section (3) of section 40A shall be made and no payment shall be deemed to 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:-
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(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;"

The said rule says that if the payment is made by a person to his agent who is required to make payment in cash for goods and services on behalf of such person: Admittedly, Shri Arnit Dutta is only the agent of Hutchison Essar Ltd and not the assessee as could be seen very clearly from the Associate Distributor Agreement entered into by the assessee which is on records before us and before the lower authorities. Hence the payment made by the assessee to Shri Arnit Dutta would not fall under the exception clause of Rule 6DD(k).

4.9. We find that one of the grounds raised by the assessee is violation of principles of natural justice on the part of the Learned CIT(A) to enhance the assessment without giving enhancement notice to the assessee. But from the order of the Learned CITA, it is specifically mentioned that the assessee was given due opportunity and show cause notice for enhancement of assessment by Rs. 54,01,473/- for making further additions on account of section 40A(3) of the Act. We find that the assessee had not come on any affidavit before us refuting this finding. Hence the enhancement made by the Learned AO cannot be faulted with on violation of principles of natural justice.

4.10. In view of the aforesaid facts and circumstances and respectfully following the judicial precedents relied upon hereinabove, we have no hesitation in deleting the addition made in the sum of Rs. 60,50,890/- and 54,01,473/- u/s 40A(3) of the Act. Accordingly, the grounds raised by the assessee in this regard are allowed.

5. In the result, the appeal of the assessee is allowed."

16. From the facts of the assessee's case, we find that as the authorities below have not made any enquiry about the identity of the payee thereby not doubting the same and neither the genuineness of the transaction in the matter has been in question. The source of payment is also not been doubted by the authorities below, therefore, the

decision rendered by ITAT, Kolkata Bench in the case of *Sri Manoranjan Raha vs. ITO (supra)*, is squarely applicable to the facts of the case. We, accordingly, set aside the orders of the authorities below and delete the disallowance of Rs.18,16,738/-. Ground No. 2 of appeal of assessee is hereby allowed.

17. Ground No. 3 is general in nature, therefore, need not required to be adjudicated.

18. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on 31.08.2023

Sd/-	**Sd/-**
(RAJESH KUMAR) **ACCOUNTANT MEMBER**	**(SONJOY SARMA)** **JUDICIAL MEMBER**

Kolkata, Dated: 31.08.2023
Biswajit, Sr. P.S.

Copy to:

1. The Appellant: Jyoti Prakash Das
2. The Respondent: DCIT, Circle-3, Guwahati.
3. The CIT,
4. The CIT (A)
5. The DR

//True Copy//

By Order

Assistant Registrar
ITAT, Kolkata Benches, Kolkata