

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 186 of 1991

For Approval and Signature:

HON'BLE MR.JUSTICE D.A.MEHTA  
and  
HON'BLE MS.JUSTICE H.N.DEVANI

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO
  2. To be referred to the Reporter or not? : NO
  3. Whether Their Lordships wish to see the fair copy of the judgement? : NO
  4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO
  5. Whether it is to be circulated to the concerned Magistrate/Magistrates, Judge/Judges, Tribunal/Tribunals? : NO

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COMMISSIONER OF INCOME-TAX

Versus

P PRAVIN & CO

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Appearance:

1. INCOME TAX REFERENCE No. 186 of 1991  
MR MANISH R BHATT with Mrs.M.M.Bhatt for  
applicant-revenue.  
NOTICE SERVED for Respondent-assessee.
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CORAM : HON'BLE MR.JUSTICE D.A.MEHTA  
and  
HON'BLE MS.JUSTICE H.N.DEVANI

Date of decision: 30/11/2004

ORAL JUDGEMENT

(Per : HON'BLE MR.JUSTICE D.A.MEHTA)

1. The Commissioner of Income-tax, Gujarat IV, Ahmedabad, the applicant herein has sought the opinion of this Court on the following five questions of law under Section 256(2) of the Income-tax Act, 1961 ("the Act"), stated to arise out of the Tribunal's order dated 21st February, 1986 in ITA No.1576/Ahd/1984.

(1) Whether, on the facts and in the circumstances of the case, both the Commissioner of Income-tax (Appeals) and Income-tax Appellate Tribunal are right in view in deleting the addition of Rs.1,11,015/- as made by the I.T.O. on account of suppression of stock of steel rounds?

(2) Whether, when the I.T.O. with due approval of Inspecting Assistant Commissioner had made the addition of Rs.1,11,015/- as unaccounted value closing stock, the said amount of Rs.1,11,015/- was required to be deleted?

(3) Whether, the finding of the Appellate Tribunal that the addition of Rs.1,11,015/- as made by the I.T.O. is not justified is correct in law and sustainable from material on record?

(4) Whether, the Appellate Tribunal is right in law and on facts in holding that addition of Rs.4,16,932/- cannot be justified under section 40A(3) of the I.T.Act, 1961 in view of the exceptions contained in Rule 6DD(j) of Income-tax Rules, 1962?

(5) Whether, the payments of huge amounts exceeding Rs.2500/- made by the assessee were covered by exceptions in Rule 6DD(j) of I.T.Rules, 1962 and therefore addition of Rs.4,16,932/- under section 40A(3) was not justified in law?

2. The respondent-assessee is a registered firm carrying on construction work on contract basis. The assessment year is 1979-80, and the relevant accounting period is the year ended 30th June, 1978.

3. The Assessing Officer made addition of Rs.1,11,015/- towards items not shown as closing stock at the end of the accounting period. According to the Assessing Officer, the assessee had vide Bill no.504 debited purchase account on 30th June, 1978 by a sum of Rs.1,40,501/- towards 12mm steel rounds received from one M/s. Lucky Trading Company. The Assessing Officer,

further took note of the fact that on the same day, the assessee had issued a debit note showing return of steel rounds worth Rs.29,426/-. According to the Assessing Officer, as the difference to the tune of Rs.1,11,015/-was not reflected in the closing stock, the addition was made.

4. The explanation tendered by the assessee that the steel rounds had been received earlier in point of time and had been consumed in the construction work was not accepted by the assessing authority. The reasons for not accepting the explanation were, firstly, that the materials were such that they could not have been utilized within a short period, and the onus was on the assessee to prove that such materials purchased had, in fact, been consumed and were, therefore, not available as closing stock. The assessee's further explanation that the closing stock reflected the actual quantity of the items lying with the assessee was rejected for the reason that the verification of the stock was carried out by the employees of the assessee, and hence, the said items could have been excluded by the staff on being instructed to do so by partners of the assessee firm.

4.1 The assessee carried the matter in appeal before the Commissioner of Income-tax (Appeals), who for the reasons stated in his order dated 19th March, 1984 accepted the explanation tendered by the assessee and deleted the addition.

5. The Assessing Officer had further made addition to the tune of Rs.4,55,420/- by invoking provisions of section 40A(3) of the Act. The case of the Assessing Officer was that out of the total purchase of Rs.12.72,863/-from Lucky Trading Company, the assessee had made payment in cash to M/s. Lucky Trading Company on various dates as stated hereunder, of respective amounts mentioned against each of the dates:

Date of Payment	Amount paid
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15-10-77	Rs.1,50,000/-
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24-11-77	Rs.1,50,000/-
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11-1-78	Rs.1,10,000/-
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30-6-78	Rs. 6,932/-
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Rs.4,16,932/-

5.1 The letter filed by the assessee from M/s.Lucky Trading Company that the said party had to urgently procure materials from the market, and hence, had

insisted for payment in cash was not accepted by the Assessing Officer on the ground that the said concern was a sister concern closely connected with the assessee firm, as there were common partners in both firms. Additional reason assigned by the Assessing Officer is that until 24th November, 1977 though Rs.3,00,000/- had been paid in cash by the assessee to M/s. Lucky Trading Company goods to the tune of Rs.24,690/- only had been received by the said date, and hence, the explanation tendered by the assessee was not accepted. The Assessing Officer further noted the fact that there was an agreement between the assessee and M/s. Lucky Trading Company and that M/s. Lucky Trading Company was an income-tax payer, and further that payments for other purchases had been made by cheques, and hence, according to the Assessing Officer, no exceptional reasons or justification was forthcoming for making payments in cash, and hence, provisions of section 40A(3) of the Act were applicable.

5.2 There were cash payments to five other parties which have also been disallowed by the Assessing Officer.

6. The assessee carried the matter in appeal before C.I.T. (Appeals), who for the reasons stated in his order deleted the disallowance under section 40A(3) of the Act in relation to payments made to M/s. Lucky Trading Company, but simultaneously upheld the disallowance in relation to payments made to five other parties.

7. The revenue carried the matter in appeal before the Income-tax Appellate Tribunal, who for the reasons stated in its order confirmed the order of C.I.T. (Appeals) on both the counts i.e. deletion of addition on account of undisclosed closing stock as well as disallowance by invoking provisions of section 40A(3) of the Act. It is this order which is under challenge before the Court.

8. Mrs.M.M.Bhatt, learned Standing Counsel, appearing on behalf of the applicant-revenue submitted that insofar as addition regarding closing stock is concerned, it was apparent that both the appellate authorities have failed to appreciate the reasons advanced by the Assessing Officer for making the addition. She reiterated the reasons which weighed with the Assessing Officer in adding a sum of Rs.1,11,015/-towards undisclosed closing stock and submitted that the order of the Tribunal and the C.I.T. (Appeals) be reversed and the assessment order on this

count be restored.

9. In relation to disallowance under Section 40A(3) of the Act, it was submitted by Mrs.Bhatt that Section 40A(3) is couched in mandatory terms, opens with a non obstante clause and was required to be strictly applied. That only exception that was permissible in law was by virtue of Rule 6DD(j) of the Income-tax Rules, 1962 ("the Rules"). That the case of the assessee did not fall within any of the exceptions specified in the rules and in the circumstances, the provisions of section 40A(3) of the Act have to be strictly applied to the facts of the case and the disallowance should be upheld by reversing the orders of the Tribunal and the C.I.T.(Appeals). It was further submitted that both the appellate authorities have failed to appreciate the reasoning adopted by the Assessing Officer for making the disallowance, and had been swayed by irrelevant considerations like agreement between the assessee and M/s. Lucky Trading Company. Elaborating on the submission it was contended that an agreement between the parties cannot be permitted to override statutory provisions, and such an agreement would, even otherwise, be a self-serving document and cannot be taken into consideration. She expressed apprehension that in case such an agreement is permitted to prevail, it would be simple for all the assessees to enter into such agreements so as to frustrate statutory provisions, and in the circumstances, it be held that the orders of the appellate authorities suffered from the vice of perversity and were bad in law.

10. Though served, there is no appearance on behalf of the respondent-assessee.

11. The C.I.T. (Appeals) has found that on perusal of records and scrutiny of evidence produced before the Assessing Officer, it was apparent that the assessee had been in receipt of building materials as and when requirement arose, but the bills were raised later in point of time by M/s.Lucky Trading Company. In other words, the dates of delivery of certain materials differed from the various dates mentioned in bills in respect of the same materials for which the bills were made subsequently; in some cases, the time lag being even four months. It has further been found by Commissioner (Appeals) that this evidence was never tested or put to proof by the Assessing Officer. He has further found that this situation prevailed in relation to bill nos.501 to 565, and all these bills have been debited in the purchase account on the same date, and the total value of the said bills runs to Rs.4.7 lakhs approximately. That

the Assessing Officer has merely taken up bill no.504 out of the aforesaid bills for the purpose of making addition to the closing stock. The Commissioner (Appeals) has further taken into consideration that if other materials received under various other bills are shown to have been consumed, the Assessing Officer has failed to bring on record any evidence to draw an adverse inference regarding user of the items purchased under bill no.504.

11.1 The first appellate authority has also tested the case of the assessee from another angle. According to the appellate authority consumption of materials to the total receipts works out to around 58% in the immediately preceding assessment year, namely, assessment year 1978-79 and 59% in the year under consideration (excluding the addition of stock). That gross profit margin disclosed in case of the assessee has been 15.3%, 15.8% and 15.1% for assessment years 1977-78, 1978-79 and 1979-80 respectively. If the addition of closing stock made by the Assessing Officer is upheld the gross profit in the adjusted trading account would get enhanced to 19.3%, but as against that the Assessing Officer himself has found that gross profit in this type of cases, namely, carrying on construction activity, is around 16% only. That, in fact, the Assessing Officer has made addition to the book results by adding a sum of Rs.24,000/- by adopting gross profit rate of 16%. Thus, according to the C.I.T. (Appeals), even on this ground, no separate addition for alleged undisclosed closing stock is warranted. The aforesaid findings on record by C.I.T. (Appeals) have been upheld by the Tribunal. In light of the facts which have come on record, there is no infirmity in the concurrent findings of fact recorded by the appellate authorities in deleting the addition on account of alleged undisclosed closing stock and no interference is called for. Even otherwise, as noted hereinbefore, the findings recorded by the appellate authorities are findings of fact after appreciating the evidence on record, and there is no question of law involved in relation to the addition regarding addition of undisclosed closing stock.

12. So far as the addition on account of disallowance under section 40A(3) of the Act is concerned, the position in law is well settled by a decision of this Court in the case of Hasanand Pinjomal V. Commissioner of Income-tax, Gujarat [1978] 112 ITR 134. This Court has held as under by interpreting provisions of section 40A(3) of the Act and Rule 6DD(j) of the Rules:

"Held, that section 40A(3) was intended to serve

the objective of checking tax evasion and ensure that payments exceeding Rs.2,500 are made by crossed cheque or bank draft so that it will be easier to ascertain, when deduction is claimed, whether the payment was genuine and whether it was made out of income from disclosed sources. The section is mandatory and there is no discretion left with the taxing authority under this sub-section to allow expenditure which does not comply with it. The rigour of the rule contained in this subsection is, however, relaxed to some extent by the second proviso to the said sub-section which provides that no disallowance under this subsection shall be made where any such payment is made otherwise than by a crossed cheque or a crossed bank draft, in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, consideration of business expediency and other relevant factors. Those guidelines will have to be borne in mind while interpreting the provisions of the relevant rules enacted by the competent authority, so that by a constricted or artificial construction of those rules, the very object of the legislature is not frustrated.

Clause(j) of rule 6DD sets out four circumstances in which the rigour of the rule contained in sub-section (3) of section 40A has to be relaxed. We are concerned in this case with one of these conditions, namely, where payment in the manner provided in section 40A(3) is not practicable. The meaning of the word "practicable" in the ordinary parlance must prevail in the context of rule 6DD(j). If the object of the enactment, namely, to relax the rigour of sub-section (3) of section 40A in genuine and bona fide cases to avoid hardship and harassment, is borne in mind, the adoption of the ordinary meaning which is quite wide would be justified, because it would advance the cause rather than defeat it. Accordingly, the word "practicable" in rule 6DD(j)(2) must be held to signify, as stated in the dictionary and in Corpus Juris Secundum, that which is feasible, that is to say, capable of being put into practice, done or accomplished with the available means and resources. In determining the practicability for the purposes of rule 6DD(j)(2), regard will have to be had to the facts and circumstances of each case.

Practicability for the purposes of rule 6DD(j)(2) must be judged from the point of view of the businessman and not of the revenue. For the purposes of carrying on his business, a businessman may have to make payment other-wise than by crossed cheque or draft in certain circumstances voluntarily and not out of sheer necessity.

The legislature, therefore, prescribed in the second proviso to section 40A(3) business expediency as one of the relevant factors. Therefore, practicability has to be judged from the angle of the businessman and not of the revenue."

13. Applying the aforesaid principles, the findings recorded by the C.I.T. (Appeals) and the Tribunal may be appreciated and tested. It has been concurrently found by both the authorities that the agreement between the parties. i.e. the assessee and M/s. Lucky Trading Company has not been doubted; in other words, the existence or the genuineness of the agreement is not in dispute. That as per the terms of the agreement M/s. Lucky Trading Company was required to keep sufficient materials in stock so as to supply the same to the assessee as and when the requirement arose; for rendering of the said service or facility, M/s. Lucky Trading Company was entitled under the agreement, to insist on cash payment as and when need arose. The agreement stipulates penalty Clause no.7 whereunder on failure of Lucky Trading Company to supply the material, it became liable to pay 10%; and correspondingly on refusal of the assessee to make payment in cash when demanded by M/s.. Lucky Trading Company, the assessee became liable to pay penalty at the rate of 10%. It is further found by the authorities that out of total purchases of Rs.12,72,863/only a sum of Rs.4,16, 932/- was demanded in cash by M/s. Lucky Trading Company. Thus signifying that, the transaction in question was not for the purposes of evasion of tax as only about one-third payment of the total purchases from the said party had been made in cash. It has further been found by the appellate authorities that many of the payments are in round figures and the payments in cash are in advance, for the goods received subsequent in point of time, and bills have been raised subsequently. That M/s. Lucky Trading Company is assessed to tax by Income-tax Officer Ward "K", Ahmedabad and it has specifically placed on record a letter showing the necessity of payment in cash and insisting for same. It is further recorded by the appellate authorities that the Assessing Officer has failed to summon the payee and examine the recipient on this point to ascertain the actual necessity for making the payment in cash. In the circumstances, it was not open to the Assessing Officer to draw an adverse inference by discarding the evidence in the form of letter of M/s. Lucky Trading Company. That the said letter was in consonance with the requirement and spirit of Circular no.220 dated 31st May, 1977 reported in [1977] 108 ITR (STATUTES) 8. It is further found that



the fact that both the firms had some common partners was not a factor which would permit disallowance under section 40A(3) of the Act for the simple reason that M/s.Lucky Trading Company was accepted as a separate entity and has been assessed as such. That once identity of the payee was established, genuineness of the payment was not doubted, the materials purchased under cash payments were utilized for construction activity carried on by the assessee, it was not possible to hold that the purpose of payment in cash was to frustrate proper investigation by the department. In light of the aforesaid findings of fact recorded after appreciating the evidence on record, the appellate authorities have deleted the disallowance made by the Assessing Officer.

14. As held by this Court, requirement under rule 6DD(j) regarding practicability of payment otherwise than in cash and consideration of business expediency has to be judged from the point of view of the businessman and not of the revenue authorities. It becomes apparent that the Tribunal has applied the correct tests on the facts found concurrently by the appellate authorities. The revenue has not been able to point out any relevant factors which have been omitted from consideration by the appellate authorities; nor has it been able to point out any irrelevant factors which have gone into the decision making process. In the circumstances, it is not possible to state that the orders of the Tribunal or the C.I.T. (Appeals), for that matter, suffer from vice of perversity as suggested by the learned Advocate appearing on behalf of the revenue.

15. In the circumstances, there being no error of law in the order of the Tribunal, it is not possible to accept the contention on behalf of the revenue that it had committed any error in deleting the addition of Rs.4,16,932/- under section 40A(3) of the Act by holding that the payments made in cash by the assessee were covered by exceptions in rule 6DD(j) of the Rules.

16. In the result, all the five questions referred to the Court for its opinion are answered in favour of the assessee and against the revenue. The Reference stands disposed of accordingly. There shall be no order as to costs.

(D.A.Mehta,J.)

(Ms.H.N.Devani,J.)

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