

**IN THE INCOME TAX APPELLATE TRIBUNAL  
"C" BENCH : BANGALORE**

**BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT  
AND SHRI JASON P BOAZ, ACCOUNTANT MEMBER**

ITA No.2444 & 2445/Bang/2018
Assessment year : 2013-14 & 2014-15

Sri Krishnasa Bhute, Pooja Nilaya, 60 Feet Road, A Block, Vidyanagar, Harihar-577 601.  PAN – AEBPB 5686G.	Vs.	The Income Tax Officer, Wa5rd-2(1), Davangere.
APPELLANT		RESPONDENT

Appellant by	:	Shri Pranav Krishna, Advocate
Respondent by	:	Dr. P.V Pradeep Kumar, Addl. CIT (DR)

Date of hearing	:	21.08.2019
Date of Pronouncement	:	28.08.2019

**ORDER**

***Per Bench :***

These are appeals by the Assessee against two orders both dated 18.6.2016 of CIT(A), Davangere, relating to AY 2013-14 & 2014-15.

2. One of the issue to be decided in these appeals is common in AY 2013-14 & 2014-15. These appeals were heard together. We deem it convenient to pass a common order.

3. The common issue involved in these two appeals are as to whether the revenue authorities were justified in making a

disallowance of a sum of Rs.1,59,63,655 and Rs.1,38,75,714 by invoking the provisions of Sec.40A(3) of the Income Tax Act, 1961 (Act) in AY 2013-14 & 2014-15 respectively.

4. The Assessee is an individual. He carries on business of distributing alcoholic beverages of Karnataka State Beverages Corporation Ltd. (KSBCL) and also does the business of trading in Maize as Proprietor M/S. Mandara Traders. In AY 2013-14, the Assessee purchased Maize (an Agricultural Produce) from the following parties (Unregistered dealers) of the value of Rs.1,59,63,655/- for which the payments were made in cash in excess of Rs.20,000/-:

Sl.No	Name of the persons	Date	Amount(in Rs.)	Total ( in Rs.)
1	Anjanappa Ittigudi	22-06-2012	372840	372840
2	Bakesh Bannikode	28-11-2012	346800	707160
		28-03-2012	360360	
3	Gangappa Bathi	22-06-2012	239370	1167479
		26-06-2012	180713	
		29-11-2012	396941	
		17-03-2013	350455	
4	Hanumanthappa Bathi	06-07-2012	339760	746320
		28-03-2012	406560	
5	Maheshanna Jigali	24-06-2012	253699	253699
6	Malthesh Naik Thimlapurr	27-06-2012	238266	1098748
		18-12-2012	243905	
		06-07-2012	327112	

		29-11-2012	289465	
7	Matthesh Sarathi	13-07-2012	293260	406770
		18-03-2013	133510	
8	Manjanna Hanagavadi	22-06-2012	249755	249755
9	Pakirappa Banuvalli	24-06-2012	247365	1461272
		28-11-2012	274040	
		13-12-2012	176882	
		22-01-2013	387260	
		17-03-2013	375725	
10	Puttappa Kauli	27-06-2012	240096	240096
11	Rakesh Bannikode	26-06-2012	242333	242333
12	Ramappa Bannikode	01-12-2012	346250	742498
		11-12-2012	396248	
13	Ramesh Banuvalli	06-07-2012	69915	806735
		07-12-2012	385030	
		16-12-2012	351790	
14	Ramesh Bathi	20-07-2012	256875	484015
		05-12-2012	227140	
15	Ramesh Harihar	13-03-2013	434700	434700
16	Rangappa Bannikode	05-07-2012	296360	
		13-12-2012	360100	
		28-01-2013	486420	1142880
17	Shambu Banuvalli	05-12-2012	353175	353175
18	Shanmukha Bannikode	24-06-2012	400325	400325
19	Shivakumar Bathi	06-07-2012	179706	532881
		02-12-2012	353175	
20	Shivaram Naik Balur	04-07-2012	399776	914056
		16-07-2012	126480	
		13-12-2012	387800	
21	Shivayya Dudihalli	05-07-2012	280364	656807
		30-11-2012	376443	
22	Suresh Pallagathi	16-07-2012	197810	197810
23	Suresh Tharaganahalli	26-06-2012	234240	1376409
		31-03-2013	374880	
		06-12-2012	409267	
		11-12-2012	358022	
24	Swamy Dudihalli	26-06-2012	306830	954892
		11-12-2012	252762	
		01-02-2013	395300	
			<b>15963655</b>	

5. Under the provisions of Sec.40A(3) of the Act, if expenditure is claimed as a deduction in computing income from business and if such expenditure in excess of Rs.20,000/- are paid in cash then the said expenditure will not be allowed as deduction in computing income from business. The relevant provisions of Sec.40A(3) of the Act reads as follows:

**“Section 40A: Expenses or payments not deductible in certain circumstances.**

(1) 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".

(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.

...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.”

6. However, Income Tax Rules, 1962 (rules) provides in Rule 6DD of the Rules, certain circumstances under which Sec.40A(3) of the Act will not be attracted. The clause relevant for the present case is as follows:

‘6DD. Cases and circumstances in which payment in a sum exceeding twenty thousand rupees may be made otherwise than by an account payee cheque drawn on a bank or account payee bank draft.-No disallowance under clause (a) of sub-section (3) of section 40A shall be made and no payment shall be deemed to be the profits and gains of business or profession under clause (b) of sub-section (3) of section 40A where any payment in a sum exceeding twenty thousand rupees is made otherwise than by an account payee cheque

drawn on a bank or account payee bank draft in the cases and circumstances specified hereunder, namely:

(a) to (d).....

(e) where the payment is made for the purchase of-

(i) agricultural or forest produce; or

(ii) the produce of animal husbandry (including livestock, meat, 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.”

7. It can be seen from the aforesaid Rule 6DD(e) of the Rules that if the payment is made for purchase of Agricultural produce to a producer of such produce, then no disallowance can be made u/s.40A(3) of the Act. The AO proposed to disallow the expenditure incurred in cash in excess of Rs.20,000/- in cash u/s.40A(3) of the Act. The Assessee pleaded that the payment in question was made for purchase of Maize agricultural produce to the cultivator of the produce and hence no disallowance can be made u/s.40A(3) of the Act read with Rule 6DD(e) of the Rules. The Assessee also filed the names and village of each of the persons to whom payments were made and the bills evidencing sale of the produce to each of the Agriculturist. The Assessee pointed out that under Section 65(2A) of the Karnataka APMC (Regulation)Act, 1966, agricultural produce cannot be moved unless market fee on such produce is paid. The said regulation reads thus:

*"[(2A) The market fee payable under this section shall be realized as follows, namely:-*

*(i) if the produce is sold through a commission agent, the commission agent [shall] realize the market fee from the purchaser and shall be liable to pay the same to the committee;*

*[(ia) if the produce is sold by an importer to the purchaser, the importer shall realize the market fee from the purchaser and shall be liable to pay the same to the committee; ]*

***(ii) if the produce is purchased directly by a trader from a producer, the trader shall be liable to pay the market fee to the committee;***

*(iii) if the produce is purchased by a trader from another trader, the trader selling the produce [shall] realize it from the and shall be liable to pay the market fee to the committee; and*

*(iv) in any other case of sale of such produce, the purchaser shall be liable to pay the market fee to the committee.]"*

8. The Assessee claimed that as purchaser it had paid market fee falling within the ambit of clause (ii) and therefore the payment in question was for purchase of an Agricultural produce to a producer of such produce and therefore cannot be disallowed u/s.40A(3) as the payment fell within the exception of clause (e) to Rule 6DD of the Rules.

9. The AO was of the view that the Assessee has not produced details like address and identity of the persons to whom cash payments were made except producing bills and their names and the name of their village to which they belong. The AO was also of the view that the extent of their land holding and the fact that they

raised the produce i.e., the maize that was sold to the Assessee has not been established. With regard to payment of Market fee, the AO held that the Assessee gives a self declaration that produce was procured from farmers to the APMC and such declaration is not enough to prove the case of the Assessee. He therefore added a sum of Rs.1,59,63,655 to the total income of the Assessee. The CIT(A) confirmed the action of the AO.

10. In AY 2014-15, the facts are identical, except that the Assessee in that year claimed that each of the payment made in cash was less than Rs.20,000 and therefore provisions of Sec.40A(3) of the Act are not attracted. This claim was rejected by the AO for the following reasons.

*The assessee was asked to explain the logic and reason behind the aforesaid pattern, where in the supplier, residing about 6 to 7 Kms away from the assessee's business premise, be it a farmer or a dealer of commodities, has to make about 38 visits to the assessee's premises, literally on a daily basis to collect the money due to him in small amounts over a period of -full nine months. The assessee was also asked to either produce a few suppliers with whom he has carried on such transaction for cross verification and also furnish individual accounts statements/ control statements in this regard. The same has not been furnished.*

*It is very difficult to believe, in fact impossible to believe that all his suppliers have the patience and the persistence to make multiple visits to the assessee's premises on a day to day basis to collect small amounts which is due to them, despite their personal and business related pre-occupations.*

*The assessee is portraying a very unusual scenario and business practice just to cover up some actual transactions which have happened and have a direct bearing on the assessee by way of a additional tax.*

*As discussed above herein, In reality, it appears that the assessee has made cash payments to these suppliers in excess of the amount prescribed and has attracted the*

*.. provision of section 40A(3) of the Act. As an afterthought, and with a view to avoid disallowances and incidence of taxation under the aforesaid provisions, the assessee has created and planted this alibi.*

*11. It is pertinent to bring on records, herein, that for the AN 2013-14, assessment u/s 143(3) in the case had resulted in findings which lead to disallowances under the provisions of section 40A(3). The assessment has resulted in disallowances of purchases as the payments were made in excess of the limits allowed under the Act.*

*To avoid a repetition of such disallowances, the assessee has come up with a master plan, which is discussed above herein.*

*After giving due consideration to the claims and counter claims of the assessee on the one hand and the facts and circumstances of the case on the other hand, and in the interest of natural justice, it is held that, if not the entire payments, at least part of the payments towards purchases have definitely exceeded the threshold limit prescribed under the Act and need to be brought under the purview of the provisions of the section 40A(3) of the Act.*

***12. Accordingly a sum of Rs 1,38,75,714, being 25% of the total payments (total U RD Purchases reflected are Rs.5,55,02,856.) claimed to have been made towards purchases is held to be payments made in excess of the limit prescribed under the Act, (but camouflaged as payments below the limit) and hence brought under the purview of the provisions of the section 40A(3) of the I.T.Act and are resultantly disallowed invoking the aforesaid provisions.***

11. The action of the AO was confirmed by the CIT(A). Hence these appeals by the Assessee before the Tribunal.

12. Before the Tribunal, the Assessee reiterated submissions made before the lower authorities and further relied on the decision of the Hon'ble Gujarat High Court in the case of Prl.CIT Vs. Keshavala Mangaldas (2018) 96 taxmann.com 83 (Gujarat) wherein the facts were that the assessee, was a Commission Agent for purchase/sale of food-grain and held licence issued by the Agricultural Produce Market Committee. In the Assessment, the AO noticed that the assessee purchased goods of Rs. 2,83,55,337/-wherein payments exceeding Rs. 20,000/- were made in cash to various parties. In the Books of Account, the aforesaid amount was shown to have been paid to various farmers and even the receipts were also produced. However, the assessee could not furnish/produce those persons/farmers and the assessee explained that it could not produce furnish the names and addresses of the persons to whom cash payment was made because farmers are known by village name they come from and it is difficult and rather impossible to track them now. The A.O. made disallowance of Rs.2,83,55,377/- under Section 40A(3) of the I.T. Act. On an appeal before the learned CIT (A), the learned CIT (A), relying upon and/or considering Rule 6DD(e)(i) of the Income Tax Rules, 1962, deleted the disallowance under Section 40A(3) by observing that as the payment was made for agricultural produces, as per the aforesaid provision, it was open for the assessee to make the payment in cash above Rs. 20,000/. The Tribunal confirmed the order of the CIT(A). On further

appeal by the Revenue, the Hon'ble Gujarat High Court held as follows:

**“4.** It is required to be noted and it is not in dispute that the assessee is engaged in the business as a Commission Agent for purchase/sale of food-grain/agricultural produces and is also holding licence issued by the Agricultural Produce Market Committee. In the Books of Accounts, the assessee has shown the amount of Rs. 2,83,55,337/- paid to various farmers. However, as the payments were exceeding Rs. 20,000/- in cash, the A.O. made the disallowance under Section 40A(3) of the Act. However, considering Rule 6DD(e)(i) of the Income Tax Rules, 1962, and when the payment was made by cash exceeding Rs. 20,000/-, it was permissible if the same was paid for purchase of agricultural produces. **It is required to be noted that in the present case, in the Books of Accounts, the said payment was shown to be paid to various farmers and even the receipts were also produced but the assessee could not produce the farmers/list of farmers for which a reasonable explanation was also given.** However, without rejecting the Books of Accounts, the learned A.O. made the addition under Section 40A(3) of the Act which is rightly deleted by the CIT (A) and rightly confirmed by the learned ITAT. In the present case, Rule 6DD(e)(i) shall be applicable and the same is rightly applied by the learned CIT (A) as well as the learned ITAT. It cannot be disputed and it is not disputed that as such, the assessee was engaged in the business of Commission Agent for purchase/sale of food-grain and is also holding licence issued by the Agricultural Produce Market Committee.

**5.** Considering the aforesaid facts and circumstances of the case, when the disallowance made by the learned A.O. under Section 40A(3) of the Income Tax Act has been deleted by the learned CIT (A) and the same has been confirmed by the learned ITAT, it cannot be said that the same is contrary to the provisions of the Act and/or erroneous. No substantial question of law arises. Hence, the present appeal deserves to be dismissed. Accordingly, it is dismissed.”

13. The learned DR relied on the order of the revenue authorities and further relied on the decision of the Hon'ble supreme Court in the case of Attar Singh Gurmukh Singh Vs. ITO (1991) 59 taxman 11 (SC) wherein the Hon'ble Apex Court upheld the constitutional validity of Sec.40A(3) and further observed that genuine and bonafide transactions will not be affected by the aforesaid provisions by quoting the erstwhile Rule 6DDj of the Rules. The learned DR submitted that in the present case the genuineness of the transaction has not been established by the Assessee by producing the farmers and therefore the addition should be sustained. He also relied on the decision of the Hon'ble Karnataka High Court in the case of ACIT Vs. Saraswathi Iron Foundary (2006) 157 Taxman 368 (Karnataka) wherein exception was claimed by an Assessee under the erstwhile Rule 6DDj but could not prove the ingredients necessary to satisfy the said clause and hence the addition was sustained.

14. We have given a careful consideration to the rival submissions. The Hon'ble Supreme Court upheld the constitutional validity of Sec.40A(3) in the case of Attar Singh Gurmukh Singh Vs. ITO 191 ITR 667 (SC). The Hon'ble Supreme Court observed that the provision has been enacted as one of the measures for countering evasion of tax. It was found from experience, that deductions were being claimed for payment made from unaccounted money in the computation of business or professional income. This provision was enacted to enable the assessing authority to ascertain whether the payment was genuine or whether it was out of the income from undisclosed sources. The Hon'ble Supreme Court referred to Rule

6DD(j) of the Rules as it existed prior to its modification with effect from assessment year 1996-97, which contained, in clause (j), a general exception which involved a scrutiny of the unavoidable circumstances and the impracticability of payment by crossed cheque or bank draft. Clause (j) before the amendment stood as under :

“Clause (j) : In any other case where the assessee satisfies the Assessing Officer that the payment could not be made by crossed cheque 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.”

and observed that Genuine and bona fide transactions are taken out of the sweep of the sub- section. The Hon'ble Supreme Court held that 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 sub-section (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 cash payment. The provisions of sub-section (3) and rule 6DD are intended to regulate business transactions and to prevent the use of unaccounted money or to reduce the chances to use black money for business transactions. The restraint that has been imposed is to curb the chances and opportunities to use or create black money and the same should not be regarded as curtailing the freedom of trade or business.

15. The above observations of the Hon'ble Supreme Court are in the context of Rule 6DDj of the Rules which have been deleted from AY 1996-97 the erstwhile Rule 6DD(j) of the Rules, is no longer available for an Assessee as a defence to a disallowance u/s.40A(3) of the Act. The decision of the Hon'ble Karnataka High Court in the case of Sri Saraswathi Iron Foundary (sura) is also on the basis of erstwhile Rule 6DDj of the rules. It is because of the requirements of erstwhile rule 6DDj that the aforesaid observations have been made by the Hon'ble Supreme Court. In the present appeal, we are concerned with Rule 6DD (e) and there is no requirement of production of the payee.

16. The facts of the decision of the Hon'ble Gujarat High Court and the facts of the case of the Assessee are identical and therefore the said decision and the ratio laid down therein is squarely applicable to the present case. As held therein when considering Rule 6DD(e)(i) of the Income Tax Rules, 1962, and when the payment was made by cash exceeding Rs. 20,000/-, it was permissible if the same was paid for purchase of agricultural produces. If there are entries in the books of accounts and payment is shown to have been made to farmers and when receipts were also produced but the assessee could not produce the farmers/list of farmers for which a reasonable explanation was also given, no addition could be made u/s.40A(3) of the Act. Respectfully following the aforesaid decision, we hold that the disallowance made u/s.40A(3) of the Act deserves to be deleted and the same is hereby deleted.

17. There is one additional issue to be decided in Assessee's appeal for AY 2014-15 viz., disallowance of interest expenses u/s.36(1)(iii)

of the Act. The facts in this regard are that the Assessee also indulged in purchase and sale of shares during the relevant previous year and those purchase and sale of shares and commodities and resultant gain were admittedly to be regarded as “Speculative Transactions” and “Speculation Income”. The Assessee had in fact earned speculative income and had claimed set off of this year's speculative business income against the brought forward speculative loss of the previous years. The AO also noticed that the source of funds for the Speculative business was from the loan A/c of the assessee with Dhuc Bank. The interest on account of this loan debited to the Profit & Loss account was Rs. 27,14,720. The AO was of the view that since the borrowed loans on which interest was paid were used in speculative business, to the extent it is so used, the Assessee should not get deduction of interest expenses u/s.36(1)(iii) of the Act in respect of non-speculative business income declared in the Profit and Loss account. These finding were put across to the assessee by the AO and he called upon the Assessee to justify the debits on account of interest at Rs.27,14,720/- on an outstanding loan liability of Rs. 33,81,008 as at 31-03-2014. The assessee submitted that he has utilised part of the loan amounts for speculative and share trading business but a major part is used for his other business particulars like maize trading, and liquor retails. The AO however disallowed a sum of Rs 6,78,680 being 25% of the interest expenses claimed in the profit and loss account of Rs.27,14,720.

18. Before CIT(A) the Assessee submitted that the disallowance was excessive and made the following submissions:

**“Disallowance of interest u/s 14A**

*As submitted in the Statement of Facts and Grounds of Appeal, the Appellant deals in shares and commodities, which is a speculative business. The details of such transactions were furnished during the course of assessment proceedings. The details of payments made and received from the two accounts of Destimony Securities and Anand Rathi Shares and Stock Broker Ltd were also furnished. These payments for purchase of shares were made from the books of head office Manoranjan Wine Shop. Out of the total interest debited at Rs 2714720 - to the P & L A/c, the amount debited in head office books is Rs 244956/- and in the books of branch, Mandara Traders, is Rs 2469764/-. The details of which were furnished in the financial statements filed with the return of income and during the course of assessment proceedings.*

*However the learned Assessing Officer, arbitrarily without evidence, has disallowed a sum of Rs 678680/- being 25% out of the total interest debited at Rs. 2714720/-, stating that 'this disallowance is done on pro rata basis on the proportion of loan amount utilised for the purpose of dealing in shares and other speculative transactions, from which no taxable income'. This finding of the Assessing Officer is unwarranted in the facts and circumstances of the case. As per the books of accounts, which are got audited u/s 44AB, accounts are separately maintained in respect of dealing in shares and commodities and the amount of interest debited is at Rs.2,44,956. It is also not correct to say that the said interest expenditure was incurred for earning non taxable income. Income derived from dealing in such shares is liable to tax as speculative income and for this year Rs 1181506/- is declared in the return of income as Speculative Income. Hence the said interest is an*

*admissible expenditure and provisions of section 14A are not applicable.”*

19. The CIT(A) did not consider any of the above pleas but proceeded to uphold the order of the AO, observing as follows:

*5b. I have perused the submissions and case laws relied upon by the appellant. The appellant is only diverting attention. As can be seen from the extract of his written submission, he is referring to section 14A whereas the AO - has not used that section. Therefore, his submissions are misplaced. The AO has only disallowed a portion of interest claimed stating that the same is used-for non-business purpose. The appellant has chosen to make use of the opportunity provided and has not cared to file details. In the absence of the same, the order of the AO is confirmed. In view of the above, I am constrained to uphold the order of the AO which calls for no interference. Thus, the ground fails.”*

20. Both the parties agreed that since, the issue raised by the Assessee with regard to borrowed funds not having been used for speculative business and the fact that there was income from speculative business and therefore even otherwise the deduction should have been allowed while computing income from speculation business, has not been considered by CIT(A) and since facts need to be examined in this regard, the matter should be remanded to the AO. We direct accordingly.

21. In the result, ITA No. 2444/Bang/18 is allowed, while ITA No.2445/Bang/2018 is partly allowed.

Pronounced in the open court on **28<sup>th</sup> August, 2019.**

Sd/-

Sd/-

( JASON P BOAZ )  
Accountant Member  
Bangalore  
Dated, the 28<sup>th</sup> August, 2019.

( N.V. VASUDEVAN )  
VICE PRESIDENT

/Vms/

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By

Assistant Registrar, ITAT, Bangalore

1. Date of Dictation .....
2. Date on which the typed draft is placed  
before the dictating Member .....
3. Date on which the approved draft comes to Sr.P.S  
.....
4. Date on which the fair order is placed  
before the dictating Member .....
5. Date on which the fair order comes back to the  
Sr. P.S. ....
6. Date of uploading the order on  
website.....
7. If not uploaded, furnish the reason for doing so  
.....  
Dictation note enclosed .....
8. Date on which the file goes to the Bench Clerk  
.....
9. Date on which order goes for Xerox &  
endorsement.....
10. Date on which the file goes to the Head Clerk  
.....
11. The date on which the file goes to the Assistant  
Registrar for signature on the order  
.....
12. The date on which the file goes to dispatch  
section for dispatch of the Tribunal Order  
.....