

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD**TAX APPEAL NO. 105 of 2014****With****TAX APPEAL NO. 106 of 2014**

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RAJMOTI INDUSTRIES....Appellant(s)

Versus

ASSISTANT COMMISSIONER OF INCOME TAX....Opponent(s)

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Appearance:

MR SN SOPARKAR, SR. ADV. with MR B S SOPARKAR, ADVOCATE for the Appellant(s)
No. 1

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CORAM: **HONOURABLE MR.JUSTICE AKIL KURESHI**
and
HONOURABLE MS JUSTICE SONIA GOKANI**Date : 01/04/2014****ORAL ORDER****(PER : HONOURABLE MR.JUSTICE AKIL KURESHI)**

1. These appeals are filed by assessee challenging the common judgment of the Income Tax Appellate Tribunal ("the Tribunal" for short) dated 30.9.2013.

2. Facts being similar, we may notice those arising in Tax Appeal No.105 of 2014. Appeal involves assessment year 2007-08. For the said assessment year, assessee filed return of income declaring total income of Rs.83.28 lakhs (rounded off). The return was taken in scrutiny. The assessing officer framed order of

assessment dated 31.12.2009. In such order, he disallowed a sum of Rs.26,72,198/- being 20% of the total payment of Rs.1,33,60,988/- made by the assessee during the year under consideration otherwise than by account payee cheque in violation of provisions of section 40A(3)(a) of the Income Tax Act, 1961 (for short " the Act").

3. The assessee carried the matter in appeal. CIT(Appeals) dismissed the assessee's appeal. CIT(Appeals) examined further facts as urged by the assessee for which remand report was called for from the assessing officer.

4. He highlighted such facts as under:-

4.5 All this factual matrix clearly establishes that the cheques were otherwise than Account Payee Cheques. There were "&Co." cheques, and is found during the course of investigation, one of the partners of Shree Swaraj Oil Mill, JamKhambhalia in his statement on oath, has also admitted that they have encashed the entire payment received from M/s. Shree Rajmoti Industries through different Shroffs, vis. Pari Pankajkumar Jasubhai, Kishan Enterprise and others. On verification of Ch.Nos.196277, 195523, 195579, 195625, 195691, 195800 as mentioned above, there is a clear acceptance of the endorsement by the Partner/Proprietor of M/s. Shree Swaraj Oil Mill, JamKhambhalia in favour of Kishan Enterprise. Therefore, the evidences in the form of endorsement and acceptance noted down on the overleaf side of the above Ch.196277,

195523, 195579,195625,195691,195800 category confirmed that these cheques were not A/c. Payee cheques. Further on the reverse side of Ch.Nos.196225,196370,& 192943 shows the name of Pari Pankajkumar Jasubhai, Paresh J. Thakkar (HUF) are mentioned. Thus, considering the statement of the partner of M/s. Shree Swaraj Oil Mill, JamKhambhalia, who confirms the fact that these cheques are "&Co" cheques only, and therefore, have been encashed. The above fact proves the statement of the partners of Shree Swaraj Oil Mill, JamKhambhalia that they have encashed the entire payment received from M/s. Shree Rajmoti Industries through different Shroffs viz. Pari Pankajkumar Jasubhai, Kishan Enterprise and others. As mentioned earlier, "Account Payee Cheques" cannot be transferred or encashed. The credit for that cheque is to be given into the account of drawee only, in whose name the cheque is drawn. On the basis of these facts and the investigation made during the course of remand, it clearly proves that the continuance claim of the appellant during the course of assessment proceedings and appellate proceedings that the payment to M/s.Shree Swaraj Oil Mill, JamKhambhalia have been made through an Account Payee cheque is false. Further, in remand report, the Assessing Officer has also pointed out that certificate filed by the appellant has not been issued by the Bank. This fact also shows that the appellant has tried to place a false claim by submitting the documents which he knew that are not true. On the basis of all above facts and in the circumstances, there is enough evidence to point out that there is violation of provisions of section 40A(3)(a) of the Act and the Assessing Officer has rightly considered that payments made to M/s. Shree Swaraj Oil Mill, Jamkhambhalia after 13-07-2006 amounting to Rs.13360988/- are otherwise than by Account Payee Cheques, and thereby, there is violation of provision of section 40A(3)(a) of the Act. The Assessing Officer, therefore, rightly disallowed 20% of above payment of Rs.13360988/-, which comes to Rs.2672198/- and added the same to the total income of the

appellant. It is also noticed that the legislature in terms has removed the provisions of Rule 6DD(j) keeping in view the intention that main purpose of introducing provisions of section 40A(3) was to curb proliferation of black money. The payment for the purchase of goods is covered by section 40A(3) of the Act as has been held by the Hon'ble Punjab & Haryana High Court in the case of Hari Chand Virendra Paul vs. CIT 140 ITR 148. The provisions section 40A(3) are construed strictly as has been held by various courts."

5. The assessee carried the matter in further appeal before the Tribunal. The Tribunal in the impugned judgment held and observed as under:-

"10. We have heard both the parties and carefully considered their submissions. Section 40A(3) deals with expenses not deductible in certain circumstances. Prior to assessment year under appeal, i.e., AY 2007-08, section 40A(3)/(4) mandated disallowance of 20% of any expenditure if payment exceeding twenty thousand rupees was made, against such expenditure, otherwise than by "a crossed cheque drawn on bank or by a crossed bank draft." The aforesaid provisions were amended with effect from 13th July 2006 to substitute the expression ' a crossed cheque drawn on a bank or by a crossed bank draft' in sub-sections (3) and (4) of section 40A, by 'an account payee cheque drawn on a bank or account payee bank draft'. The reasons for amendments made in section 40A(3) and the purpose that they seek to achieve have been explained in Circulation No.1/2007 dated 27.4.2007 issued by the Central Board of Direct Taxes as under:-

"14. Expenses or payments not deductible in certain circumstances-Section 40A(3).

14.1 The existing provisions contained in sub-section (3) and sub-section(4) of section 40A provide that twenty per cent. of the expenditure shall not be allowed as a deduction if payment in a sum exceeding twenty thousand

rupees is made, against such expenditure otherwise than by a crossed cheque or crossed bank draft.

14.2 A crossed cheque or crossed bank draft is not a non-negotiable instrument. This has, at times, resulted in crossed cheques being endorsed making it difficult to trace final payee and thus defeating the provisions of section 40A(3). However, as per the RBI's instructions to commercial banks, an account payee cheque or account payee bank draft cannot be credited to any account other than the account of the payee. The Act has accordingly amended the aforementioned sub-section (3) and sub-section (4) to substitute the expression 'a crossed cheque drawn on a bank or by a crossed bank draft', in both the sub-sections, by 'an account payee cheque drawn on a bank or account payee bank draft'.

14.3 These amendments take effect from 13th July, 2006."

11. The amendments made in section 40A(3) are intended to enable the Income-tax authorities to track the transactions between the assessee and the payee in order to ensure that they are properly recorded and accounted for not only by the assessee but by the payee also. The aforesaid object would be completely frustrated if an assessee claiming deduction of expenditure was allowed to make payments in respect thereof in a manner different from the one prescribed in section 40A(3). The legislative policy, which is so clearly and unambiguously expressed in section 40A(3), cannot be allowed to be diluted so as to frustrate the object that it seeks to achieve. Unquestionably, the amendments have been carried out in section 40A(3) for strict enforcement and compliance. The fact that they are intended for strict compliance is also evident from the fact that they are not subject to any reasonable cause or exception. If an assessee seeks to claim deduction of any expenditure involving payments exceeding Rs.20,000/-, he must ensure that such payments

are made as per prescription of section 40A(3) else the amount claimed as deduction would not qualify for deduction. It is well-established that when law requires a particular thing to be done in a particular manner, it should then be done in that manner else it should be ignored.

12. At the time of hearing, it was contended by the ld.counsel for the assessee that the term " account payee cheque" used in section 40A(3) has neither been defined in the Income-tax Act nor in the Negotiable Instruments Act and hence "crossed cheques" issued by the assessee in the name of M/s Shree Swaraj Oil Mill should be taken as sufficient compliance of the requirement of section 40A(3). We are unable to agree with the aforesaid submissions. Circular issued by the CBDT (supra) refers to the instructions issued by the Reserve Bank of India to the banks in which the difference between a crossed cheque and account payee cheque has been brought out. While account payee cheque is credited by the drawee bank to the bank account of the payee and none else, crossed cheque can be negotiated and thus can be credited by the drawee bank to the bank account of a person other than the payee. Account payee cheque is well covered by the definition of "cheque" as given in section 6 of the Negotiable Instruments Act read with section 5 thereof. In this view of the matter, payments made by a crossed cheque cannot be considered as payment by account payee cheque. Law requires payments to be made by an account payee cheque and not by a crossed cheque. In this view of the matter, all the arguments taken by the assessee in this behalf are rejected.

13. Another submission of the assessee at the time of hearing was that the purchases in respect of which impugned payments have been made were genuine and therefore section 40A(3) cannot be invoked. Such a plea cannot be accepted for the detailed reasons given by a co-ordinate bench of this Tribunal in T.G.Mutha v. ITO, 54 ITD 460 and other decisions referred to by the AO in the assessment other. Besides,

section 40A(3) is neither subject to any reasonable cause nor to any exception. Once payment exceeding Rs.20,000/- is shown to have been made otherwise than by account payee cheque drawn on a bank or account payee bank draft, the expenditure in respect of which such payment has been made cannot be allowed as deduction.

14. The assessee-firm has made impugned payments exceeding Rs.20,000/- in a day for purchases made by it from M/s. Shree Swaraj Oil Mill and claimed deduction in respect thereof while computing its profits. It is admitted by the ld. Counsel for the assessee that the impugned payments exceeding Rs.20,000/- were made otherwise than by account payee cheque drawn on a bank or account payee bank draft. Thus all the conditions for the applicability of section 40A(3) are fully satisfied. We are therefore unable to interfere with the order passed by CIT(A) confirming the impugned disallowance in both the assessment years under appeal. His orders in this behalf are confirmed. Both the appeals filed by the assessee are dismissed."

6. It is this order of the Tribunal which the assessee has challenged raising following question for our consideration:-

"Whether, in the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in law in confirming the action of the CIT(A) of disallowing Rs.26,72,198/- under the provisions of Section 40A(3)(a) of the Act?"

7. Learned Senior Counsel Mr. S.N.Soparkar appearing with learned counsel Mr.B.S. Soparkar submitted that payments were made through cheques which were discounted through shroffs and payments were received

by the drawees of the cheques. Thus the fact that all payments were received by the drawees was established. This being the paramount consideration of legislature for enactment of section 40A(3) of the Act, disallowance would not be justified. He further submitted that there is no distinction in law between a crossed cheque and an account payee cheque. Term "an account payee cheque" is not defined either under the Act or under the Negotiable Instruments Act and is, therefore, not capable of a precise meaning. He also drew our attention to the decision of this Court dated 22.1.2014 in the case of **Anupam Tele Services vs. Income Tax Officer** passed in **Tax Appeal No.556 of 2013**, in which though it was found that the assessee had made payment in breach of section 40A(3) of the Act, disallowance was deleted.

8. Section 40A(3)(a) of the Act as it stood at the relevant time provided that where the assessee incurs any expenditure in respect of which payment is made in a sum exceeding Rs.20,000/- otherwise than by an account payee cheque drawn on a bank or account payee bank draft to the extent of 20% of such expenditure, shall not be allowed in respect of such expenditure.

In subsequent year this disallowance of deduction was increased to 100% of the expenditure.

9. Previously the language used in the said provision was "a crossed cheque drawn on a bank or by a crossed bank draft". Such provision was amended with effect from 13.7.2006 to substitute the expression "an account payee cheque drawn on a bank or account payee bank draft". Thus there was a conscious change in the phraseology used in the said provision and the expression "a crossed cheque drawn on a bank" was replaced by "an account payee cheque drawn on a bank". Likewise, expression "a crossed bank draft" was replaced by "an account payee bank draft". The reasons for such amendments were explained in CBDT Circular No.1 of 2007 dated 27.4.2007 providing inter alia that a crossed cheque or a crossed bank draft is not a non-negotiable instrument. This, at times, results in crossed cheques being endorsed making it difficult to trace final payee and thus defeating the provisions of section 40A(3). As per RBI instructions to banks, an account payee cheque or account payee bank draft cannot be credited to any account other than the account of the payee. The Act was accordingly amended

to substitute the said expressions.

10. It is true that the terms "an account payee cheque" or "account payee bank draft" have not been defined either in the Act or under the Negotiable Instruments Act. This by itself would not mean that the term is not possible of specific understanding nor would a statutory provision cease to have effect merely because an important term contained therein is not defined under the Act. The terms are defined to the extent the legislature intends to give them specific meanings defining important terms either in inclusive, expansive or exhaustive manners or even giving rise to deeming fictions. It is not mandatory that every term used in the statute must carry its definition under the Act itself. Terms which are not defined would be open to interpretation in its ordinary sense of the term.

11. It is indisputable that the term "an account payee cheque" is well understood and signifies cheque which carries a mandate to have the amount mentioned in the cheque to be paid to the drawee of the cheque. In common parlance and as per RBI directives, it would, thereafter, not be open to the drawee of the

cheque to endorse the cheque in favour of another person. In this context, we may refer to RBI directives contained in its circular dated 23.1.2006 to the banks.

12. Though this circular was not presented before the Tribunal, the Tribunal did take note of RBI directives in this respect. We notice that the circular provides as under:-

"As banks are aware an account payee cheque is required to be collected for the payee constituent. As regards, account payee cheques drawn in favour of the banks, it had been indicated, vide our circular DBOD.No.BC.23/21.01.001/92 dated September 9, 1992, that banks which credit cheques drawn in their favour by other banks marked 'A/c. Payee' to the accounts of constituents who are not named payees therein, without proper mandate of the drawer do so at their own risk and will be responsible for the unauthorized payment.

2. In view of the recent misuse of Initial Public Officer (IPO) process by certain individuals/entities and reports received in this regard from SEBI, the Reserve Bank of India took up detailed investigations at some banks to ascertain the modus operandi adopted by different parties in manipulating the system. It was observed that despite the abovementioned instructions, banks had credited the proceeds of individual account payee refund orders into the accounts of the brokers instead of to the individual accounts on the request of the associates of DP providers. This has resulted in manipulation of the payment system and has facilitated the perpetration of irregularities. This manipulation would not have taken place but for the banks deviating

from the procedure for collection of account payee cheques. The deviations can also not be sanctified as a prudent market practice since it has the potential to expose the banks to various risks.

3. Being satisfied that in consonance with the legal requirements and in particular the intent of the Negotiable Instruments Act, and with a view to protect the banks being burdened with liabilities arising out of unauthorized collections, and in the interest of the integrity and soundness of the payment and banking systems, and in order to prevent recurrence of deviations observed in the recent past, the Reserve Bank has considered it necessary to prohibit the banks from crediting 'account payee' cheque to the account of any person other than the payee named therein. The Reserve Bank accordingly directs the banks that they should not collect account payee cheques for any person other than the payee constituent.

4. Where the drawer/payee instructs the bank to credit the proceeds of collection to any account other than that of the payee, the instruction being contrary to the intended inherent character of the 'account payee' cheque, bank should ask the drawer/payee to have the cheque or the account payee mandate thereon withdrawn by the drawer. This instruction would also apply with respect to the cheques drawn by a bank payable to another bank. Instructions contained in the Bank's circular DBOD No.BC.23/21/01.001.92 dated September 9, 1992 shall stand modified to that extent.

5. These directions are issued in exercise of the powers conferred under section 35A of the Banking Regulation Act, 1949."

13. This circular was issued by RBI in exercise of powers under section 35A of the Banking Regulations Act, 1949, which empowers the Reserve Bank of India to give directions where it is satisfied that in the

public interest or in the interest of the banking policy or to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company or to secure the proper management of any banking company generally. Thus in exercise of statutory powers such directions came to be issued. Such directions clearly mandate that the banks would be prohibited from crediting account payee cheque to the account of any person other than the payee named therein. RBI further directed the banks that they should not collect account payee cheques for any person other than the payee constituent. It is further provided that where the drawer/payee instructs the bank to credit the proceeds of collection to any account other than that of the payee, the bank must ask the drawer/payee to have the cheque or the account payee mandate thereon withdrawn by the drawer.

14. These directions thus in no uncertain terms mandate the banks to credit the amount of an account payee cheque only in the account of the payee and no other person and conversely not to accept any cheque from any source other than the person named in the

account payee cheque except after requiring the drawer of the cheque to withdraw the mandate in this respect.

15. Thus, by virtue of the clear understanding of an account payee cheque in commercial parlance further amplified by RBI guidelines noted above, it cannot be said that there is no distinction between a crossed cheque and an account payee cheque. The concept of an account payee cheque which is even otherwise well known in banking circles and commercial parlance; with specific unambiguous directives by RBI gets further amplified. The banks are duty bound to carry out such directions issued by the RBI in exercise of powers under section 35A of the Banking Regulations Act.

16. As we have noted, previously the expression used in section 40A(3)(a) was a crossed cheque or a crossed bank draft. With specific purpose in mind, the same was amended by the legislature to be replaced by the expression " an account payee cheque or account payee bank draft". This was done in the background of the experience that even crossed cheques were being endorsed in favour of a person other than the drawee making it difficult to trace the constituent of the money. To plug this possible loophole the requirement

of section 40A(3) was made more stringent. If we accept the contention of the counsel for the assessee that there was no distinction between a crossed cheque and an account payee cheque, we would be obliterating this amendment brought in the statute with specific purpose in mind.

17. Learned Senior Counsel Mr. Soparkar further contended that in law, Courts have recognized no such distinction. Our attention was drawn to the decision of Privy Council in the case of **Universal Guarantee Pty. Ltd. vs. National Bank of Australasia, Ltd.** reported in [1965] 2 All England Law Reports 98 in which it was observed that addition of the words "A/c Payee" or "A/c. Payee only" referred to the payee named in the cheque and not the holder at the time of the presentation and that would not prevent further negotiability of the cheque. For the same purpose reliance was also placed on the decision of the Calcutta High Court in the case of **Messrs. Tailors Priya, a firm vs. Messrs. Gulabchand Danraj, a firm** reported in AIR 1963 CALCUTTA 36 (V 50 C 11). In the three Judge Bench judgment, Justice D.N.Sinha in separate concurring judgment touched the aspect of

negotiability of an account payee cheque and observed as under:-

"18. This curious position in law is not known to the public at large. It is generally believed that by crossing a cheque with the words "a/c payee only", it is made non-negotiable. Indeed, such endorsements are made in order to render it non-negotiable, and as a measure of safety. In my opinion, the law on the point should be reconsidered and there is no reason why we should blindly follow the English law on the point. However, the position seems to have been so uniformly accepted by text book writers, both in England and India, that I am unable to depart from that view on the strength of my own feelings about it. The matter should however be corrected by legislation. I therefore hold that according to the law as it stands at present, a cheque payable to order or bearer and crossed "a/c payee" or "a/c payee only" but without the endorsement, "not negotiable", is a negotiable instrument, and may be negotiated, but the collecting banker has a duty to put the money, when collected, into the account of the payee indicated, and into no other account."

18. It may be that insofar as legal implication is concerned, even an account payee cheque may still retain its negotiability unless it carries a further endorsement "non-negotiable". To this aspect of the matter we are neither called upon nor intended to give any conclusive opinion. We, however, cannot resist referring to the decision of the Calcutta High Court in the case of **Messrs. Tailors Priya, a firm vs. Messrs. Gulabchand Danraj, a firm** (supra). In such

decision also it was observed that a law on the point should be reconsidered and it is generally believed that by crossing a cheque with the words "a/c. Payee only", it is made not negotiable. It is clarified that according to the law as it stands at present a cheque even if it is account payee without the endorsement "not negotiable" would still be negotiable instrument.

19. In the present case, when RBI directives command the banks not to deposit the cheque amount in favour of any person other than the drawee of the cheque and correspondingly prohibit the banks from accepting any cheque, which is account payee cheque from a source other than the drawee, lack of any distinction between a crossed cheque and an account payee cheque without a further endorsement "not negotiable" would be of no further relevance.

20. For the purpose of section 40A(3) of the Act, thus there is really a clear distinction which exists, must be recognised and implemented as required in the plain language used therein.

21. Learned Senior Counsel Mr. Soparkar as we may recall, has also placed reliance on the judgment of

this Court in the case of **Anupam Tele Services vs. Income Tax Officer** (supra). It was, however, a peculiar case where the payments other than by way of account payee cheques were made under compulsion. Various peculiar facts noticed by the Court were as under:-

[b] In the present case, the appellant assessee was compelled to make cash payments on account of peculiar situation. Such situation was as follow -

[i] the principal company, to which the assessee was a distributor, insisted that cheque payment from a cooperative bank would not do, since the realization takes a longer time;

[ii] the assessee was, therefore, required to make cash payments only;

[iii] Tata Teleservices Limited assured the assessee that such amount shall be deposited in their bank account on behalf of the assessee;

[iv] It is not disputed that the Tata Teleservices Limited did not act on such promise;

[v] if the assessee had not made cash payment and relied on cheque payments alone, it would have received the recharge vouchers delayed by 4/5 days and thereby severely affecting its business operations.

We would find that the payments between the assessee and the Tata Teleservices Limited were genuine. The Tata Teleservices Limited had insisted that such payments be made in cash, which Tata Teleservices Limited in turn assured and deposited the amount in a bank account. In the facts of the present case, rigors of section 40A(3) of the Act must be lifted."

22. It was in this background that the Court resorted to Rule 6DD(j) of the Income Tax Rules, 1962 and deleted the disallowance. It is true that in such case genuineness of the payments and receipts of the amounts by the payee was one of the factors, however by no means a sole factor. Several other peculiar facts noted and highlighted above, went into the Court taking a decision that it had taken. In the present case, no such additional facts emerge. CIT(Appeals) in fact noted a futile attempt on part of the assessee to show that the cheques were A/c payee. Assessee relied on documents which were not genuine. We may, however, proceed on the basis that the payments were in fact received by respective drawees of the cheques. Admittedly, however, there was no other additional ground, compelling reason or commercial expediency, which would have left no choice, would have compelled the assessee to make payment other than by account payee cheques. It was this overwhelming consideration of impossibility of making the payments through the mode other than by account payee cheque which had convinced us to accept the case of the assessee in the case of **Anupam Tele Services vs. Income Tax Officer** (supra). It was when the assessee would have got out

of the business that if ignored the directions of the principal and continued to make payment by account payee cheques the Court granted relief in the said case.

23. In the result, the Tribunal, in our opinion has correctly interpreted the provisions of section 40A(3) in background of the facts arising in these appeals. Tax Appeals are, therefore, dismissed.

(AKIL KURESHI, J.)

(MS SONIA GOKANI, J.)

SUDHIR

