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**IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH**

**Income-tax Appeal No.125 of 2004 and other connected appeals being ITAs No. 127 and 128 of 2004.**
**Date of decision: 10.3.2011.**

**Commissioner of Income-tax (Central), Ludhiana**

**...Appellant**

**Versus**

**M/s Sai Metal Works** **...Respondent**

**CORAM: HON'BLE MR.JUSTICE ADARSH KUMAR GOEL**
**HON'BLE MR.JUSTICE AJAY KUMAR MITTAL**

Present: Ms. Urvashi Dhugga, Senior Standing Counsel for the appellant.

Mr. Pankaj Jain, Advocate for the respondent.

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**ADARSH KUMAR GOEL, J (**Oral**).**

1. This order will dispose of ITAs No.125, 127 and 128 of 2004, as it is stated that question of law involved in these appeals is common.

2. ITA No.125 of 2004 has been preferred by the revenue under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as "the Act") against order dated 23.9.2003 passed by the Income Tax Appellate Tribunal, Amritsar Bench, Amritsar in IT (SS)/No.3/(ASR)/2003, for the block period 1.4.90 to 6.4.2000, claiming following substantial question of law:-

> "Whether on the facts and in the circumstances of the case, the ITAT was right in law in holding that the

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disallowance under Section 40A(3) cannot be made in block assessment?"

3. The assessee filed its return for the block period 1.4.90 to 6.4.2000. The assessing officer in the course of the assessment made addition on account of claimed expenses being found to be in violation of Section 40A(3) of the Act. It was observed that the seized material revealed that ledger containing the details of purchases made against cash payment exceeding Rs.20,000/- which could not be allowed and on that account addition towards undisclosed income had to be made. The assertion of the assessee was that on that account disallowance could not be made. The assessing officer did not accept this plea with the following observations.

> "I do not agree with the argument put forth by the assessee because the examination of seized material shows that cash book and ledger etc. have been maintained by the assessee. Although these cash book and ledger have not been maintained in normal course but it has been noted that the assessee had developed his own accounting system. It is noted that the balance sheet as on 4.4.2000 has been prepared after taking into account the expenses debited in cash book and ledger. Thus, the assessee has taken care of all expenses while preparing the balance-sheet. As the assessee has claimed the expenses, the disallowance u/s 40A(3) has

rightly been made in respect of those expenses which have been made in violation of provisions of Section 40A (3) of the Income-tax Act, 1961. Further, the rationale of incorporating the provisions of Section 40A(3) were explained by the Hon'ble Supreme Court in the case of **Attar Singh Gurmukh Singh Vs. ITO Ludhiana, 191 ITR 667.** It was explained by Hon'ble Supreme Court that while interpreting the taxing statutes, the Court cannot be oblivious of the proliferation of black money, which is under circulation in our country. Any restraint intended to curb the chances and opportunities to use or create black money should not be regarded as curtailing the freedom of trade or business. It was held that the provisions of Section 40A(3) and Rule 6DD intended to prevent use of unaccounted money or reduce the chances to use black money for business transactions. In the light of these observations, it would be going totally against the judgment of the Hon'ble Supreme Court to hold that the provisions of Section 40A(3) should not be applicable in respect of unaccounted business.

This view also is supported by the decision of learned Andhra Pradesh High Court in the case of **S.Venkata Subarao Vs. CIT** reported in **173 ITR 340** in which it has been held that:-

"There is no doubt about the proposition that profits

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and gains derived from an illegal business are liable to be taxed. Such profits and gains are to be determined in accordance with the provisions of the Act. It is not possible to hold that some of such provisions do not apply to the taxable income in the case of an illegal business while some others do. May be that in an illegal business it may not be practicable to comply with the requirements of section 40A(3) but that only means that such illegal business ought not be carried on. By carrying on a business out of his regular books of account he cannot be placed at an advantage as compared to other carrying on their business as per books in implemented section 40A(3)."

Reliance is also placed on the decision of Hon'ble Income Tax Appellate Tribunal, Chandigarh Bench as per their order dated 06.3.2000 in appeal No.ITA No.1063 (Chd.)/1996 for the block assessment in the case of Sh. Madan Lal Basi Vs. ACIT, Central Circle, Ludhiana. With these observations, I, therefore, disallow an amount of Rs.9,26,673/- @ 20% of Rs.46,33,364/- u/s 40A(3) of the Income-tax Act, 1961 which is brought to tax in the hands of the present assessee."

4. The CIT(A) set aside the addition which view has been upheld by the Tribunal. It was held that Section 40A(3) could not be

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invoked in the case of the assessee where block assessment was by estimate on the basis of GP rate. The finding recorded by the Tribunal is as under:-

> "We have considered the rival submissions and carefully gone through the material available on the record. The undisputed fact of this case is that a search was conducted at the residential premises of the partners of the assessee and the assessee declared an undisclosed income of Rs.14,54,500/- which was accepted by the A.O. by stating that income so declared was in agreement with the information brought on record. However, the A.O. invoked the provisions of Section 40A(3) while passing block assessment order and made the impugned addition. Admittedly, the entries which were taken into consideration by the A.O. were recorded in the books of account found during the course of search, however, no trading and profit and loss account was prepared to determine the income, but the income disclosed by the assessee was accepted and since no trading and profit and loss account has been prepared, there was no question of invoking the provisions of Section 40A(3). In a similar case, the I.T.A.T. Cochin Bench while deciding the issue in the case of Eastern Retreat Vs. ACIT (2000) 66-ITJ-839 held that:-
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> "No doubt, if there was violation of the provisions of

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section 40A(3) there could be disallowance of the expenses in computing the total income, but then the disallowance should be made in a regular assessment under section 143(3). In view of the provisions of Explanation below 158BA(2), it is open to the A.O. to make a regular assessment even in respect of any assessment year included in the block period and make disallowance under any provisions of the Income Tax Act. But such disallowance cannot be made in a block assessment, as in that case the assessee would be burdened with a higher rate of tax. As the procedure for assessment of the undisclosed income of the block period appears in a separate self-contained code, that assessment should be made strictly in accordance with the provisions in Chapter XIV-B. The addition on this account cannot be, therefore, sustained."

From the above, it would be clear that the disallowance under section 40A(3) cannot be made in block assessment."

5. We have heard learned counsel for the parties.

6. Learned counsel for the revenue submitted that expenditure revealed from the seized documents which were not permissible being in contravention of Section 40A(3) had been taken

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into account while preparing the balance sheet and thus profit element declared by the assessee did not truly reflect the income of the assessee. The Assessing Officer was justified in making addition on that account. The observations of the Tribunal that disallowance could be made in regular assessment under Section 143(3) and not in block assessment was not tenable in law. Explanation below Section 158BA(2) to the effect that block assessment was in addition to regular assessment was no bar to Section 40A(3). Reliance has been placed upon judgment of Madras High Court in ***M.G.Pictures (Madras) Ltd. Vs. Assistant Commissioner of Income Tax (2003) 185 CTR (Mad) 185*** and judgment of Hon'ble Supreme Court in ***Commissioner of Income -Tax Vs. Suresh N.Gupta (2008) 297 ITR 322 (SC).***

7. Learned counsel for the assessee supported the view taken by the Tribunal. It was submitted that Section 40A(3) could have no application to block assessment which was a complete Code by itself. Reliance has been placed upon the judgment of Gujarat High Court in ***Cargo Clearing Agency (Gujarat) Vs. Joint Commissioner of Income Tax (2008) 218 CTR (Guj) 541.*** It was also submitted that when assessment was made on the estimation of income by applying GP rate, Section 40A(3) could not be invoked. For this proposition reliance has been placed upon the following judgment.

(i) ***Commissioner of Income-Tax Vs. Banwarilal Banshidhar (1998) 148 CTR (All) 533;***

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(ii) ***Commissioner of Income-Tax Vs.Smt. Santosh Jain (2008) 296 ITR 324 (P&H);*** and

(iii) ***Commissioner of Income-Tax Vs.S.Mohammad Dharubudeen (2008) 4 DTR (Mad) 218.***

8. On due consideration of rival contentions, we are of the view that the question has to be answered in the negative, in favour of the revenue.

9. Chapter XIV-B was inserted in the Act by the Finance Act, 1995 providing special procedure for undisclosed income found during the search for the block period. The said Chapter lays down special procedure for the assessment and provides for special rate of tax. Section 158BH provides that unless otherwise provided in the said Chapter, all the provisions of the Act are applicable to the assessment under the Chapter. No doubt, the said Chapter contained certain special provisions such as making assessment for block period instead of assessment year, it prescribes higher rate of tax and lays down separate procedure for issuing notice etc. for assessment of undisclosed income as a result of search, Section 158BH provides that except the said special provisions all other provisions of the Act apply to assessment under this Chapter. In view of Section 158BH, argument on behalf of the assessee that Chapter was a complete Code by itself and except the provisions which are specifically mentioned for their application to the assessment under this Chapter, no other provision could be invoked. In ***Suresh N.Gupta*** Hon'ble Supreme Court while considering the

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said issue in the context of applicability of provision for surcharge to assessment under Chapter XIV-B held:-

> "There is no conflict between the computation machinery under Chapter XIV-B and normal computation machinery under Chapter IV. This is the importance behind enactment of section 158BH which inter alia states that if there is no conflict between the provisions of Chapter XIV-B and any other provisions of the 1961 Act, then the latter will operate. There is a fallacy in the argument of the assessee that the concepts of "total income" and "previous year" are given a go by in Chapter XIV-B. The above analysis of section 158BB indicates that both the concepts are retained in Chapter XIV-B. The only difference is that section 4 of the 1961 Act charges the total income of a person of one single previous year (unit of assessment) whereas section 158BA(2) levies a charge on the income of a person for the block period of previous years relevant to 10/6 assessment years. In our view, the words "block period", as defined in section 158B (a), comprises previous years relevant to 10/6 assessment years as one unit of time for the purposes of assessment. As stated above, the object behind the enactment of Chapter XIV-B is to assess and compute "undisclosed incomes" *relatable to different accounting years in which the income is earned.* Therefore, if the

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block period comprising of previous years relevant to 10/6 assessment years is treated by Parliament as one unit of time for assessment purposes, one has to correlate "undisclosed income" to each of the years in which income was earned by the assessee. It is true that under Chapter XIV-B, computation of regular income and computation of undisclosed income has to be worked out separately. However, to arrive at the figure of undisclosed income, the said parallel calculations have to converge in order to work out the difference between the first and the second aggregates of the total incomes/losses of the previous year, in which undisclosed income is taxed under section 113. Therefore, in our view, the concept of a charge on the "total income" of the previous year under the 1961 Act is retained even under Chapter XIV-B. Therefore, section 158BB which deals with computation of undisclosed income of the block period has to be read with computation of total income under Chapter IV of the 1961 Act.

Once section 158BB is required to be read with section 4 of the 1961 Act, then the relevant Finance Act of the concerned year would automatically stand attracted to the computation under Chapter XIV-B. Section 158BB looks at section 113."

10. In ***M.J.Pictures (Madras) Ltd.,*** Madras High Court

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considered applicability of Section 40A(3) to assessment proceedings Chapter XIV-B and held:-

> "In our opinion, in canvassing this, learned counsel is doing harm to the logic and is seeking to read something which is not there in the section. If some expenditures made are unearthed during the search are proved to be the genuine expenditure, they would still have to be assessed in the light of the other provisions and cannot be completely ignored merely because they ceased to become undisclosed income. It will be seen S.158BH specifically provides that excepting those provisions which have specifically been made inapplicable, all the other provisions of the Act apply to the assessment made under this Chapter. Therefore, all such expenditure which even if proved to be genuine would have to be taken into consideration while arriving at the tax liability of the assessee and it cannot just be ignored on the broad principle that since it is the genuine expenditure made, it ceased to be undisclosed income. There could be cases where even genuine expenditure which remains undisclosed and which is unearthed because of the search could be taken as an income on the part of the assessee so as to increase his tax liability. If we accept the contention then it would obtain absurd results and all the expenditures unearthed which were not disclosed by

the assessee would automatically have to be left out of consideration on the broad ground that they cannot be undisclosed income. In short, though the hypotheses is established by the amendment, its antithesis, which is tried to be argued by learned counsel, is not correct. We, therefore, reject this argument and hold that while making the assessment of the block period, such expenditure will have to be taken into consideration in the light of the other provisions in the Act as per S.158BH. The plain meaning of the amendment is only to the extent of the words added and no further inferences can be drawn on that basis as is being tried by learned counsel. The first contention is, therefore, rejected.

11. As regards the judgment of Gujarat High Court in ***Cargo Clearing Agency (Gujarat)*** relied upon on behalf of the assessee, the said judgment was before the judgment of Hon'ble Supreme Court. In the said judgment it was observed:-

> "In the aforesaid circumstances, when one considers the entire scheme relating to procedure for assessment/reassessment as laid down in the group of sections from s.147 to s.153 of the Act and compares the same with special procedure for assessment of search cases under Chapter XIV-B of the Act it becomes apparent that the normal procedure laid down in Chapter-XIV of the Act has been given a go by when Chapter

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XIV-B of the Act itself lays down that the said Chapter provides for a special procedure for assessment of search cases. The stand of Revenue that s.158BH of the Act permits all other provisions of the Act to apply to assessment made under Chapter XIV-B of the Act does not merit acceptance."

12. The above observations are in conflict with the view expressed by Hon'ble the Supreme Court and the Madras High Court. We are, thus, unable to be persuaded by the said view. Accordingly, we hold that Section 40A(3) applies to the proceedings to assessment under Chapter XIV-B.

13. As regards the said provision not being taken into account where assessment is by estimation basis on GP rate, the principle invoked in the judgments relied upon is not of universal application. If the estimated income impliedly takes into consideration the expenditure incurred, the said principle may apply. If the expenditures which are legally not permissible has been taken into account, the same can certainly be disallowed. The judgments relied upon on behalf of the assessee did not discuss the issue of impermissible expenditure. Rule 6DD of the Rules allows cash expenditure to be taken into account if circumstances in which the expenditure is incurred can reasonably explained. In the present case, the assessee has not been able to cover its case under Rule 6DD. In the circumstances, the assessing officer was justified in disallowing expenditures incurred in contravention of Section 40A(3).

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Accordingly, we hold that addition made by the assessing officer was justified and setting aside thereof by the CIT(A) and the Tribunal is not sustainable. The question raised is answered in favour of the revenue and against the assessee. The appeals are allowed.

14. A photocopy of this order be placed on the file of each connected case.

**(Adarsh Kumar Goel)**
**Judge**

**March 10, 2011** **(Ajay Kumar Mittal)**
**Pka** **Judge**