

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES “SMC-C”, BANGALORE**

Before Shri George George K, Judicial Member

ITA No.1862/Bang/2019 : Asst.Year 2014-2015

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| M/s.Unity Industries No.60, Byraveshwara Industrial Area, Heggana Halli, Vishwaneedam Post Bangalore – 560 091. PAN : AADFU6822F. | v. | The Income Tax Officer Ward 6(2)(3) Bengaluru. |
| (Appellant) | | (Respondent) |

Appellant by : Sri.R.E.Balasubramanyam

Respondent by : Sri.Ganesh R.Ghale,

Standing Counsel for Department

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| Date of Hearing : 17.11.2020 | Date of Pronouncement : 18.11.2020 |
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ORDER

This appeal at the instance of the assessee is directed against CIT(A)'s order dated 28.06.2019. The relevant assessment year is 2014-2015. The order of the CIT(A) arises out of the order of the Assessing Officer passed u/s 154 of the I.T.Act.

2. The grounds raised read as follow:-

The Appellant objects to the impugned order of the Ld CIT (A) on the grounds

1. That the impugned order of the Ld CIT(A) is opposed to facts and law of the case insofar as it is prejudicial to the interest of the Appellant.

2. That the Ld CIT(A) erred in confirming the order of rectification which is invalid and bad in law inasmuch as the rectification is carried out on the basis of a mere change in opinion by the Ld AO in respect of issues that were already scrutinized in the order passed under section 143(3) and the same could not have been a subject matter of rectification under section 154.

3. *That without prejudice to Ground no 2, the Appellant also objects to the impugned order for the following reasons that.*

a)The Ld CIT(A) and the Ld AO have failed to appreciate the fact that the cash payments are made due to commercial expediency which were beyond the control of the Appellant.

b)The Ld CIT(A) and the Ld AO erred in not following the judicial precedents wherein it is consistently held that the expenses cannot be disallowed under section 40(A)(3) if the genuineness of the expenditure were proved.

The Appellant prays for leave to add, modify, delete or introduce additional Grounds of Appeal at any time before the Appeal is disposed off.

Based on these and such other grounds that may be adduced from time to time, the Appellant requests the Honourable Income Tax Appellate Tribunal to consider the petition in the light of principles of justice and cancel the addition made by the Assessing Officer.”

3. The brief facts of the case are as follow:

The assessee is a partnership firm engaged in the business of manufacturing and fabrication of machine components. The assessment u/s 143(3) was completed vide order dated 30.08.2016. Subsequently, the A.O. issued notice u/s 154 of the I.T.Act for the reason that the assessee had made cash transaction amounting to Rs.1,25,738 during the relevant assessment year in contravention of provisions of section 40A(3) of the I.T.Act. The assessee submitted objections vide letter dated 05.02.2018 to the notice issued u/s 154 of the I.T.Act. It was submitted that the assessee firm commenced its operation in August 2013 and the bank account of the assessee firm was not active. It was stated that the assessee had some business orders in the meanwhile and for purchase of raw material out of commercial expediency had to make cash

payments, since the assessee was new in the field. The objections raised by the assessee was rejected and the A.O. passed an order u/s 154 of the I.T.Act (order dated 17.07.2018) by adding a sum of Rs.1,25,738 to the total income by invoking the provisions of section 40A(3) of the I.T.Act.

4. Aggrieved by the order passed by the A.O. u/s 154 of the I.T.Act, the assessee filed an appeal to the first appellate authority. The CIT(A) confirmed the order of the Assessing Officer passed u/s 154 of the I.T.Act. The relevant finding of the CIT(A) reads as follow:-

“The first proviso to section 40A(3) provides for certain exceptions to the application of the provisions of section 40A(3), including for considerations of business expediency, which are specified in Rule 6DD of the I.T.Rules, 1962. The appellant’s case is not covered by any of the exceptions mentioned in Rule 6DD. Therefore the provisions of section 40A(3) were clearly applicable to the appellant’s case and hence the two sums mentioned above were to be disallowed. The disallowance being in accordance with the law, it did not become a debatable issue. Omission to disallow the two amounts u/s 40A(3) was a mistake apparent from the record, hence the AO was justified in rectifying the mistake u/s 154 of the Act. The order u/s 154 dated 19.07.2018 is upheld. The grounds of appeal are dismissed.”

5. Aggrieved by the order of the CIT(A), the assessee has filed this appeal before the Tribunal. The assessee has filed two paper books enclosing therein the written submissions filed before the CIT(A), invoices of cash purchases, bank statement of the assessee, the judicial pronouncements relied on by the assessee. The learned Counsel for the assessee submitted that the A.O. has not doubted the genuineness of the transaction and order passed u/s 154 is a mere change of opinion, which

is outside the purview / mandate of the said section. The learned AR relied on the judgment of the Hon'ble jurisdictional High Court in the case of M/s.M.K.Agrotech Pvt.Ltd. v. Addl.CIT in ITA No.83 of 2010 (judgment dated 29th November, 2018) and the order of Co-ordinate Bench of the Jaipur Tribunal in the case of M/s.A.Daga Royal Arts v. ITO [ITA No.1065/JP/2016 – order dated 15.05.2018] for the proposition that when assessee proves business / commercial expediency, disallowance u/s 40A(3) is unwarranted.

6. The learned Standing Counsel submitted that the assessee's case does not come in any of the exceptions mentioned under Rule 6DD of the I.T.Rules. Further, it was submitted that the issue raised is not a debatable issue and hence, the 154 order is correct and no interference is called for.

7. I have heard the rival submissions and perused the material on record. The assessee is a partnership firm running a small-scale industry. It was submitted that the assessee was promoted by first time entrepreneurs and had commenced its operation in August 2013. It was stated that the assessee did not have necessary creditworthiness to purchase raw material on credit or by issue of cheque and the opening of the bank account was also delayed. During the said period, the assessee had received certain orders and to fulfil its orders, the assessee was in urgent need of raw material. Since the suppliers were not willing to extend credit and in view of business expediencies, the raw materials were purchased by paying cash. It was further stated that the products manufactured out

of these raw materials were sold and proceeds were offered for tax. The above submission / assertion by the assessee was not controverted by the Income Tax Authorities nor by the learned Standing Counsel before the Tribunal.

7.1 Rule 6DD(j) of the I.T.Rules was inserted with effect from 01.04.1970. Rule 6DD(j) of the I.T.Rules inserted w.e.f. 01.04.1970 was a residuary rule whereby under exceptional or unavoidable circumstances, the assessee can prove before the A.O. that it had to make cash payments. In such circumstances, the assessee can plead that the disallowance under the provisions of section 40A(3) of the I.T.Act is not warranted. The residuary rule under 6DD(j) of the I.T.Rules was omitted with effect from 27.07.1995. The reintroduced Rule 6DD(j) w.e.f. 01.12.1995 mentions specified exception to application of provisions of section 40A(3) of the I.T.Act (unlike the residuary rule which was in vogue from 01.04.1970 to 27.07.1995). However, the jurisdictional High Court for assessment year 2005-2006 in case of M/s.M.K.Agrotech Private Limited v. Addl.CIT (supra) had held that if the assessee proves the genuineness of the business expediency, it can still claim the expenditure, as an allowable deduction. The Co-ordinate Bench of Jaipur Tribunal in the case of M/s.A.Daga Royal Arts v. ITO (supra) had noticed the omission of the residuary Rule 6DD(j) of the I.T.Rules w.e.f. 27.07.1995 and in spite of omission of residuary rule w.e.f. 27.07.1995, the Co-ordinate Bench of Jaipur Tribunal had held that no disallowance u/s 40A(3) is warranted when assessee proves that cash payments are made out of business expediency. The

relevant finding of the Co-ordinate Bench of Jaipur Tribunal in the case of M/s.A.Daga Royal Arts v. ITO (supra) reads as follow:-

“25. Here, it is relevant to note that there has been no change in the provisions of section 40A(3) in so far as considerations of business expediency and other relevant factors are concerned, as existed at relevant point in time and as considered by the Hon’ble Supreme Court and the provisions of section 40A(3) as exist now and relevant for the impugned assessment year i.e. AY 2013-14. However, Rule 6DD(j) has been amended and by notification dated 10.10.2008, it now provides for an exception only in a scenario where the payment was required to be made on a day on which banks were closed either on account of holiday or strike. A question which arises for consideration is whether the legal proposition so laid down by the Hon’ble Supreme Court regarding consideration of business expediency and other relevant factors has been diluted by way of delegated legislation in form of Income Tax Rules when the parent legislation in form of section 40A(3) to which such delegated legislation is subservient has been retained in its entirety. Alternatively, can it be said that what has been prescribed as exceptional circumstances in Rule 6DD as amended are exhaustive enough and which visualizes all kinds and nature of business expediency in all possible situations.

.....

27. We do not believe that by virtue of these amendments, the legal proposition so laid down by the Hon’ble Supreme court regarding consideration of business expediency and other relevant factors has been diluted in any way. At the same time, we also believe that Rule 6DD as amended are not exhaustive enough and which visualizes all kinds and nature of business expediency in all possible situations and it is for the appropriate authority to examine and provide for a mechanism as originally envisaged which provides for exceptional or unavoidable circumstances to the satisfaction of the Assessing officer whereby genuine business expenditure should not suffer disallowance.

.....

43. In the entirety of facts and circumstances of the case and respectfully following the legal proposition laid down by the various Courts and Coordinate Benches referred supra, we are of the view that the identity of the persons from whom the various plots of land have been purchased and source of cash payments as withdrawals from the assessee's bank account has been established. The genuineness of the transaction has been established as evidenced by the registered sale deeds and lastly, the test of business expediency has been met in the instant case. Further, as held by the Hon'ble Rajasthan High Court in case of Harshila Chordia (supra), the consequences, which were to befall on account of non-observation of sub-section (3) of section 40A must have nexus to the failure of such object. Therefore the genuineness of the transactions and it being free from vice of any device of evasion of tax is relevant consideration. The intent and the purpose for which section 40A(3) has been brought on the statute books has been clearly satisfied in the instant case. Therefore, being a case of genuine business transaction, no disallowance is called for by invoking the provisions of section 40A(3) of the Act."

7.2 In the instant case, the A.O. has not doubted the genuineness of the transaction. Therefore, taking proceedings u/s 154 of the I.T.Act only goes to show that it is only a mere change of opinion, which is outside the mandate of the said section. The Hon'ble Supreme Court in the case of *ITO v. Volkart Brothers* [(1971) 82 ITR 50 (SC)] held that a mistake apparent on the record must be an obvious and patent mistake and not something which could be established by a long-drawn process of reasoning on points on which there might conceivably be two opinions. Since the assessee in the given facts, had proved that there is commercial / business expediency in making cash purchases, the mistake cannot be stated to be obvious and apparent from record in view of the

judgment of the Hon'ble jurisdictional High Court in the case of M/s.M.K.Agrotech Pvt. Ltd. v. Addl.CIT (supra) and the order of Jaipur ITAT in the case of M/s.A.Daga Royal Arts v. ITO (supra). For the aforesaid reasoning and the judicial pronouncements, I hold that the disallowance u/s 40A(3) of the I.T.Act, in a 154 proceedings is uncalled for and I quash the same. It is ordered accordingly.

8. In the result, the appeal filed by the assessee is allowed.

Order pronounced on this 18th day of November, 2020.

Sd/-
(George George K)
JUDICIAL MEMBER

Bangalore; Dated : 18th November, 2020.
Devadas G*

Copy to :

1. The Appellant.
2. The Respondent.
3. The CIT(A)-6, Bengaluru.
4. The Pr.CIT-6, Bengaluru.
5. The DR, ITAT, Bengaluru.
6. Guard File.

Asst.Registrar/ITAT, Bangalore