

ANDHRA PRADESH HIGH COURT

Mudiam Oil Co.

Vs

Income-Tax Officer

(Obul Reddi and V Rao, JJ.)

21.07.1971

JUDGMENT

Obul Reddi, J.

1. In these two writ petitions, the constitutional validity of Section 40A(3) and (4) of the Income-tax Act, 1961 (hereinafter referred to as "the Act"), has been questioned on two grounds: (1) that it is ultra vires the powers of Parliament under entry 82, List I of the Seventh Schedule to the Constitution ; and (2) that it violates the fundamental right guaranteed under Article 19(1)(g) of the Constitution. Rule 6DD is also challenged on the ground that it is beyond the competence of the rule making authority and repugnant to Article 14 of the Constitution.

2. To appreciate the tenability or otherwise of the contentions raised in these two writ petitions, it will suffice if we refer to the relevant facts stated in the affidavit filed in support of Writ Petition No. 4603 of 1970. The petitioners are all firms represented by their respective partners. They are merchants and commission agents. All of them are income-tax assesseees. According to them, the -agriculturists bring their produce in cart-loads from their respective villages to the market yard at Nizamabad and some of the merchants act as commission agents on behalf of the agriculturists and put up the produce at an auction for sale. The sale bill contains the nature of the grain or produce, weight, rate, total price brokerage and weighment charges, etc. The sales are all conducted under the supervision of the market committee, which also collects the market fee. The sellers are paid in cash for the produce the same day and the goods are delivered to the purchasers with the bills prepared. Commission to the commission agents as per the percentage noted in the bills is paid to them by cheque or draft on the 5th or 6th day after the goods are taken delivery of by the buyers. The produce bought at such auctions by the buyers normally exceeds a sum of Rs. 2,500. The commission agents pay in cash to the sellers "due to the exigencies of business, custom and nature of business" and it takes about 7 or 8 days for them to realise or collect from the buyers what has been expended on their account. They express their difficulty in

having to pay by a crossed cheque or a crossed bank draft to the sellers as required under Section 40A(3) as the sellers insist on cash payments having no accounts in banks or having no banks at all in their villages. The financial status of buyers who come from mofussil is also not known to the commission agents and, therefore, cash payments are insisted upon by them for the goods purchased. If a seller has to part with these goods accepting a cheque and in case the cheque is to be dishonoured, the option left to him is to lay action on these dishonoured cheques, which, in terms, involves him in litigation. This insistence upon payments by cheques under the impugned provisions of the Act impedes the business activities of the petitioners. In short, it is their case that the mandatory requirement for payment by a crossed cheque or a crossed bank draft under the impugned provisions acts as a

dog

affecting their fundamental right to transact their business by making payments in cash; and that they confer vast and arbitrary power on the income-tax authorities to allow or disallow any expenditure incurred towards payments made in cash and it is an unreasonable restriction on their right to carry on trade or business.

3. The applications are resisted by the respondents contending, inter alia, that the impugned provisions do not adversely affect the legitimate conduct of the business of any of the petitioners, as they are designed to ensure the honest conduct of business and maintenance of true accounts and check the malpractices hitherto existing. The restrictions imposed by the impugned provisions are reasonable and in the interests of the general public and have relation to the object sought to be achieved by the impugned provisions of the Act and are not discriminatory or arbitrary. The alleged inconvenience, if any, is not such as to warrant any inference of infringement of constitutional or other legal rights of the petitioners. The restriction imposed is only in regard to payments which exceed Rs. 2,500. Neither the impugned provisions of the Act nor the rules made thereunder are ultra vires.

4. We may now read the relevant provisions which have come in for challenge:

"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 payment is made, after such date (not being later than the 31st day of March, 1969) as may be specified in this behalf by the Central Government by notification in the official Gazette, in a sum exceeding two thousand five

hundred rupees otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, such expenditure shall not be allowed as a deduction ;

Provided that where an allowance has been made in the assessment for any year not being an assessment year commencing prior to the 1st day of April, 1969, in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year the assessee makes any payment in respect thereof in a sum exceeding two thousand five hundred rupees otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, the allowance originally made shall be deemed to have been wrongly made and the Income-tax Officer may re-compute the total income of the assessee for the previous year in which such liability was incurred and make the necessary amendment, and the provisions of Section 154 shall, so far as may be, apply thereto, the period of four years specified in Sub-section (7) of that section being reckoned from the end of the assessment year next following the previous year in which the payment was so made:

Provided further that no disallowance under this sub-section shall be made where any payments in a sum exceeding two thousand five hundred rupees is made otherwise than by a crossed cheque drawn on a bank or by 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, considerations of business expediency and other relevant factors.

(4) Notwithstanding anything contained in any other law for the time being in force or in any contract, where any payment in respect of any expenditure has to be made by a crossed cheque drawn on a bank or by a crossed bank draft in order that such expenditure may not be disallowed as a deduction under Sub-section (3), then the payment may be made by such cheque or draft; and where the payment is so made or tendered, no person shall be allowed to raise, in any suit or other proceeding, a plea based on the ground that the payment was not made or tendered in cash or in any other manner.

Rule 6DD. Cases and circumstances in which payment in a sum exceeding two thousand five hundred rupees may be made otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft.--No disallowance under Sub-section (3) of Section 40A shall be made where any payment in a sum exceeding two thousand five hundred rupees is made otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft in the cases and circumstances specified hereunder, namely :--

(a) Where the payment is made to-

(i) the Reserve Bank of India or any banking company as defined in Clause (c) of Section 5 of

the Banking Regulation Act, 1949 (10 of 1949);

(ii) the State Bank of India or any subsidiary bank as defined in Section 2 of the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959);

(iii) any co-operative bank or land mortgage bank;

(iv) any primary agricultural credit society as defined in Clause (cii) of Section 2 of the Reserve Bank of India Act, 1934 (2 of 1934), or any primary credit society as defined in Clause (civ) of that section;

(v) the Life Insurance Corporation of India established under Section 3 of the Life Insurance Corporation Act, 1956 (31 of 1956);

(vi) the Industrial Finance Corporation of India established under Section 3 of the Industrial Finance Corporation Act, 1948 (15 of 1948) ;

(vii) the Industrial Credit and Investment Corporation of India Ltd.;

(viii) the Industrial Development Bank of India, established under Section 3 of the Industrial Development Bank of India Act, 1964 (18 of 1964);

(ix) the Unit Trust of India established under Section 3 of the Unit Trust of India Act, 1963 (52 of 1963) ;

(x) the Madras Industrial Investment Corporation Ltd., Madras;

(xi) the Andhra Pradesh Industrial Development Corporation Ltd., Hyderabad;

(xii) the Kerala State Industrial Development Corporation Ltd., Trivandrum;

"(xiii) the State Industrial and Investment Corporation of Maharashtra Ltd., Bombay;

(xiv) the Punjab State Industrial Development Corporation Ltd., Chandigarh;

(xv) the National Industrial Development Corporation Ltd., New Delhi;

(xvi) the Mysore State Industrial Investment and Development Corporation Ltd., Bangalore ;

(xvii) the Haryana State Industrial Development Corporation Ltd., Chandigarh;

(xviii) any State financial corporation established under Section 3 of the State Financial Corporations Act, 1951 (63 of 1951);

(b) where the payment is made to Government and, under the rules framed by it, such payment is required to be made in legal tender;

(c) where under any contract entered into by the assessee before the 1st day of April, 1969, the payment is required to be made in legal tender ;

(d) where the payment is made by-

(i) any letter of credit arrangements through a bank ;

(ii) a mail or telegraphic transfer through a bank

(iii) a book adjustment from any account in a bank to any other account in that or any other bank;

(iv) a bill of exchange made payable only to a bank.

Explanation,--For the purposes of this clause and Clause (h), the term 'bank' means any bank, banking company or society referred to in Sub-clauses (i) to (iv) of Clause (a) and includes any bank [not being a banking company as defined in Clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949)], whether incorporated or not, which is established outside India;

(e) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;

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

(i) agricultural or forest produce ; or

(ii) the produce of animal husbandry (including 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 ;

(g) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products ;

(h) where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town.

(i) where any payment by way of gratuity, retrenchment compensation or similar terminal benefit, is made to an employee of the assessee or the heirs of any such employee on or in connection with the retrenchment, resignation, discharge or death of such employee, if the income chargeable under the head 'Salaries' of the employee in respect of the financial year in which such retirement, resignation, discharge or death took place or the immediately preceding financial year did not exceed Rs. 7,500;

(j) in any other case, where the assessee satisfies the Income-tax Officer that the payment could not be made by a crossed cheque drawn on a bank or by a crossed bank draft due to exceptional or unavoidable circumstances and also furnishes evidence to the satisfaction of the Income-tax Officer as to the genuineness of the payment and the identity of the payee."

5. Sub-section (3) of Section 40A was added by the Finance Act of 1968 and Sub-section (4) was inserted by the Finance Act of 1969. These provisions were inserted as Section 40, which prohibited deductions in certain cases specified thereunder, was found to be inadequate to achieve the object sought to be achieved, viz., checking tax evasion. Sub-section (3) injuncts that an assessee shall not be entitled to claim deduction unless, in regard to the expenditure incurred by him, payment is made where such expenditure exceeds Rs. 2,500 by a crossed cheque drawn on a bank or by a crossed bank draft. The provisos to this sub-section are not relevant for the purpose of our case. Sub-section (4) is intended to protect the assessee against the payee. Any payment made in respect of expenditure as specified in Sub-section (3) will not be open to challenge by a payee or any person in any suit or other proceeding, on the ground that the payment was not made or "tendered in cash or in other manner." Rule 6DD relaxes the rigour of Sub-section (3) as this rule specifies certain bodies or institutions to whom payments exceeding Rs. 2,500 could be made otherwise than by a crossed cheque or a crossed bank draft. The rule further provides that, in other cases not specified in the rule if the assessee satisfies the Income-tax Officer that the payment could not be made by a crossed cheque or a crossed bank draft due to exceptional or unavoidable circumstances and furnishes evidence as to the cause for non-payment by a crossed cheque or a crossed bank draft, deduction will be allowed in regard to such payments.

6. The petitioners have given an illustration in their affidavit to show the combined effect of Sub-sections (3) and (4) read with Rule 6DD and that, under certain circumstances, the provisions convert the gross receipt into income. The illustration reads:

"If a dealer purchases goods worth Rs. 1,00,000 and sells it off for about Rs. 1,25,000 without incurring any other expenses, then his income or profit in the ordinary sense of the word would be Rs. 25,000. But, in case he purchases these goods worth Rs. 1,00,000 by cash payment, then, by virtue of Section 40A(3) and (4) and the rules thereunder, the entire purchase price will be

disallowed and he will be taxed on the entire sale proceeds aggregating to Rs. 1,25,000 as income; even though the income of the dealer is Rs. 25,000, he will be assessed to tax on Rs. 1,25,000. Further, this would amount to taxing the additional amount of Rs. 1,00,000 which is not an income."

7. As already noticed, Sub-section (3) of Section 40A has been introduced to encounter problems arising out of evasion of tax. More stringent measures were required to plug the loopholes. Computation of income under the head "profits and gains of business or profession" has to be made in accordance with the provisions contained in Sections 30 to 43A. The provisions of Section 40, which deal with amounts not deductible, were found to be inadequate to deal with the evasion of tax under the cloak or guise of permissible deductions. It is to remedy that mischief resulting in loss of revenue to the State that Sub-section (3) of Section 40A was introduced. A dealer who can afford to purchase goods worth about Rs. 1,00,000, it will be reasonable to assume, will necessarily have a bank account and there is no reason why such a dealer should think of withdrawing cash from the bank and then make payment to the seller in cash when it is convenient and much more practicable to make payment by a crossed cheque or by a crossed bank draft, unless it be a case where he wants to have clandestine transactions with the unaccounted money that he possesses. Even assuming that the cash receipts on any day exceed Rs. 1,00,000 as to enable the dealer to purchase goods from cash receipts, if he can satisfy the Income-tax Officer that, having regard to exceptional or unavoidable circumstances he could not make payment by a crossed cheque or a crossed bank draft, he would still be entitled to claim deduction under Rule 6DD. The restriction imposed requiring payment, in case it should be a permissible deduction, by a crossed cheque or a crossed bank draft is not only reasonable but in public interest to save loss of revenue to the State. That apart, deductions cannot be claimed as a matter of right. The assessee claiming deduction must show that his claim comes within the four corners of the provisions which permit deduction. The commercial activities carried on by the petitioners include bargaining with the producers or sellers either purchasing the goods themselves or selling them on commission basis. They carry on the trade or business for earning profits. If the restriction on cash payments beyond the limit prescribed by Sub-section (3) of Section 40A is imposed, it is to exclude clandestine transactions with unaccounted money. The Constitution does not guarantee an unrestricted privilege to enter into commercial transactions as one pleases. As pointed out by the Supreme Court of the United States in *Nebbia v. New York*, [1934] 291 U.S. 502. 527. 528:

"The Constitution does not guarantee the unrestricted privilege to, conduct it as one pleases. Certain kinds of business may be prohibited; and the right to conduct a business or to pursue a calling may be conditioned. Regulation of a business to prevent waste of the State's resources may be justified. And statutes prescribing the terms upon which those conducting certain

businesses may contract, or imposing terms if they do enter into agreements are within the State's competency. "

8. Sub-section (3) of Section 40A is introduced only to regulate the business activities and prevent unaccounted money being used for clandestine transactions and it is in the interests of revenue and national economy that the restrictions have been imposed. They cannot, therefore, be said to curtail the freedom of trade or business.

9. The fact that Rule 6DD specifies the cases where Sub-section (3) of Section 40A will not be applicable if payments are made otherwise than by a crossed cheque drawn on a bank or a crossed bank draft, will not render the rule discriminatory on the ground that it has excluded the other classes or persons not named therein. The cases specified form a different class altogether and it is impossible to have clandestine or fictitious dealings with the institutions or bodies specified in the rule. What is required is that there must be a reasonable nexus between the cases or classes exempted and the object of the provisions under consideration. No harm will result to public revenue even if payments are made to the institutions or bodies specified in the impugned rule otherwise than in accordance with Sub-section (3) of Section 40A. Special treatment of the cases specified in the rules is founded upon a reasonable and rational basis. As pointed out in *Ramkrishna Dalmia v. Justice Tendolkar*, :

" The legislature is free to recognise degrees of harm and may confine its restrictions to those cases where the need is deemed to be the clearest."

10. The legislature is under no obligation to extend the restrictions to all classes of cases. Here, the restriction or the prohibition is extended only to such classes or cases having regard to the degree of "public injury or harm" that has occasioned by the commercial transactions. If an evil is specially experienced in a particular branch of business or persons involved in business, it is not necessary that the prohibition should embrace every other class of cases concerned with business transactions. The powers of the State to classify for purposes of taxation are of "wide range and flexibility", It is perfectly open to the legislature to exempt certain classes or cases from the operation of a particular rule so long as the exemption is based on reasonable grounds having nexus to the object sought to be achieved. In matters of taxation, the legislature possesses greater freedom in classification than in other matters and it is not possible to draw any precise line or maintain any scientific uniformity in the matter of exemption from the operation of a particular rule. It should not be forgotten that an assessee is entitled to deduction as a matter of right.

Deduction claimed must be allowable as deduction under the provisions of the Act. It is for the assessee to satisfy the Income-tax Officer that the expenditure in respect of certain items has to be taken into account for purposes of deductions.

11. It was also contended that the impugned provisions are in excess of the powers conferred upon Parliament under entry 82 in List I of the Seventh Schedule to the Constitution. Entry 82 relates to "taxes on income other than agricultural income". According to the learned counsel, the impugned provisions result in taxing the gross receipts in respect of income in the guise of disallowing the expenditure. We are unable to agree with the learned counsel. The provisions are there, as already stated by us, to safeguard the revenues of the State. If there is evasion of tax on the income and if measures are taken to check evasion, it cannot be said that the measures taken are ultra vires or beyond the powers of the legislature.

12. The Supreme Court in *Sardar Baldev Singh v. Commissioner of Income-*

tax, dealing with the scope of entry 54 of List I of Schedule VII to the Government of India Act, 1935 (corresponding to entry 82), held that it authorised not only legislation for the imposition of a tax but also legislation which prevented the tax imposed being evaded.

13. Subba Rao J (as he then was) in *Balaji v. Income-tax Officer*, held that the entries in the legislative lists of the Constitution are not powers but are only fields of legislation and the widest import and significance should be given to the language used by Parliament in the various entries. That was a case where a writ of certiorari was prayed for to quash the assessment order challenging the constitutional validity of Section 16(3)(a)(i) of the Indian Income-tax Act, 1922. Their Lordships held that the provisions were enacted for preventing evasion of tax and were well within the competence of the Federal Legislature under the Government of India Act, 1935.

14. As held by the Federal Court and Supreme Court, the power to legislate on a specified topic includes power to legislate in respect of matters which may fairly and reasonably be said to be comprehended therein. (See *United Provinces v. Mst. Atiq Begum*, [1940] F.C.R. 110 ; A.I.R. 1941 F.C. 16, *Navinchandra Mafatlal v. Commissioner of Income-tax*, *Balaji v. Income-tax Officer*, and *Check Post Officer, Coimbatore v. K.P. Abdullah and Bros.*, [1971] 27 S.T.C. 1 (S.C.)

15. It is thus manifest that entry 82, a taxing entry, confers power upon the legislature to legislate for matters ancillary or incidental including provisions for preventing evasion of tax.

16. For the reasons recorded, we are unable to find any merit in both the writ petitions and they are accordingly dismissed with costs. Advocate's fee Rs. 200.

