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Direct Tax Newsletter

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- **CBDT Releases' Handbook On Advance Rulings' to Guide/Assist Taxpayers Seeking Advance Rulings**

Press Release, dated 19-08-2023

- **CBDT Revises Rule 3 to Lower Rates of Rent-free Accommodation Valuation & Introduces an Inflation-linked Cap**

Notification No. 65/2023, dated 18-08-2023

1. ITAT Directs AO to Estimate Profit at 10% on Cash Purchases Made From Farmers in Violation of Sec. 40A(3)

In the instant case¹, the assessee was a firm engaged in the business of trading rice. It filed its return of income for the relevant year, and subsequently, a survey under section 133A was conducted on the business premises of the assessee.

During the assessment proceedings, the Assessing Officer (AO) noticed from the purchase bills and printed copies of purchase ledger accounts that the assessee had made payment in cash exceeding Rs. 20,000 for the purchase of rice to a single person in a single day. AO disallowed the cash payments made over Rs. 20,000 by invoking provisions of section 40A(3).

On appeal, CIT(A) upheld the disallowance made by AO. Aggrieved-assessee filed an instant appeal to the Chennai Tribunal.

The Tribunal held that the assessee was a trader in purchasing rice from rice mills and not from agriculturists directly. Admittedly, the assessee was also not an agent. Even the assessee could not show any business expediency that required to be considered in the light of the exceptions as provided under rule 6DD of the Rules.

The assessee argued that there was fluctuating demand for rice due to a price rise of rice commodities, and the farmers agreed to sell in cash to the rice mills. In turn, the rice mill asked the

assessee to make part of the payment for some months in cash.

Assessee claimed that it made 98% of purchases in account payee cheque or bank draft or through banking channel only as envisaged in the provisions of section 40A(3). The compulsion imposed by some of the farmers who wanted their money back from the rice mill reveals that there was business expediency to make cash payments that were a very minimal amount, ranging from 6.92% to 0.28% in various years.

Assessee argued that on the disputed purchase, AO could apply a higher profit rate instead of the profit rate declared by it. The assessee also filed a complete table capturing the facts of disputed addition, total purchases and percentage of disputed purchases.

Thus, an estimation of profit at the rate of 10% of the disputed purchases disallowed by the AO by invoking the provisions of section 40A(3) will meet the ends of justice. This prevents profit distortion and considers commercial expediency in the given facts and circumstances.

2. AO Can't Make Additions Merely Based on Form 26AS Without Verifying Total Contract Amount & Bills - HC

In the instant case², the Assessee-company had filed its return of income for the relevant assessment year. The case of the assessee was selected for scrutiny. Thereafter, assessment under section 143(3) was completed, and additions were made to

¹ **M. Shyamalanathan & Co. v. Income-tax Officer (Chennai-Trib.) [2023]**

² **PCIT v. MBC Infra Space (P.) Ltd. (Gujarat)[2023]**

the assessee's income on account of the difference in payment received as per Form 26AS and as per books of account.

On appeal, the CIT(A) deleted the additions made by AO, and the Tribunal confirmed further such deletion. Aggreived-AO filed an appeal before the Gujarat High Court.

The High Court held that the AO had not verified the assessee's claim. The assessee raised RA Bills of Rs. 8.32 crore during the relevant financial year. The assessee received an amount of Rs. 8.32 crores, out of which, as per the books of account, as per the bank statement, is of Rs. 7.7 crores only, which was received in the current year.

There was a double deduction of TDS on the same project, which was entered into with the two different parties at the time of the bill raised and at the time of payment made on certain bills.

Thus, the CIT(A) has rightly deleted the addition after verification of the bank account contract amount, which the assessee received based on running bills. Thus, after considering the facts and circumstances of the present case, the appeal preferred by the AO was liable to be dismissed.

3. Supreme Court dismissed SLP against ruling allowing deduction of Mark-To-Market loss suffered on stock in trade

In the instant case³, the Supreme Court of India has dismissed Special Leave Petition (SLP) filed by the Pr. CIT against the ruling of the High Court on issues related to the allowability of mark-to-market loss suffered on the stock in trade.

³ **Principal Commissioner of Income-tax v. DSP Merrill Lynch Capital Ltd (SC) [2023]**

The Apex Court held that there was no infirmity in High Court's judgment, and thus no interference was called for.

The High Court had ruled mark-to-market loss on open equity stock future contracts was ascertained liability. Thus, the deduction of the amount on account of market loss suffered on the stock in trade was a permissible deduction in the hands of the assessee.

4. Sec. 68 Couldn't be Invoked Just Because Unsecured Loan Received Under FDI Not Approved by Competent Authority

In the instant case⁴, the Assessee-individual engaged in the business of civil construction. During the year under consideration, the assessee received an interest-free unsecured loan from a Non-Resident Indian (NRI). On questioning by the Assessing Officer (AO), assessee submitted along with a copy of the confirmation letter that the lender was a close friend residing in Dubai. Such an interest-free loan was received on the condition that the amount would be refunded once revenue was generated from the ongoing project.

Considering that the permission of RBI to accept money from NRI was not taken, AO concluded that the assessee had not furnished proper details and treated such an amount as unexplained cash credit under section 68.

⁴ **Niteshkumar Maganbhai Patel v. Income-tax Officer (Ahmedabad-Trib.) [2023]**

On appeal, CIT(A) confirmed the additions made by AO. Aggrieved-assessee preferred an appeal to Ahmedabad Tribunal.

The Tribunal held that the provision of section 68 fastens the liability on the assessee to make a proper and reasonable explanation regarding the nature and sources of the sum credited in the books of account to the satisfaction of the AO. The assessee is liable to provide proof of the identity of the lenders and establish the genuineness of the transactions and creditworthiness of the parties.

The identity of the party refers to the existence of such a party, which can be proven based on the evidence. As such, the identity of a party can be established by furnishing the name, address and PAN detail, bank details, passport and other details of the Government agencies.

The next stage comes to verify the genuineness of the transaction. Genuineness of transaction refers to what has been asserted is true and authentic. A genuine transaction must be proved to be genuine from all prospective and not merely on paper. The genuineness of the transaction can be proved by submitting a confirmation of the party along with details of the mode of transaction, but merely showing the transaction carried out through banking channel is insufficient.

The last stage comes to verify the creditworthiness of the parties. The assessee has to establish that the creditor party has the capacity to advance such a loan and has the requisite fund in its books of account. The capacity to advance loan can be established by showing sufficient income, capital and reserve or other fund in the hands of creditors.

During the appellate proceeding, the assessee furnished a copy of PAN, confirmation letter and bank statement of the lender. Therefore, the assessee discharged the primary onus cast upon him by furnishing copy of PAN, confirmation and bank statement, and the onus shifted to the AO to bring contrary material.

AO, without bringing contrary material in the assessee's submission, treated the loan as unexplained cash credit because there was no formal loan agreement, cash flow statement of the lender, schedule of repayment and interest and permission of RBI/authority to accept money from NRI.

It was further held that when the identity and creditworthiness of the creditor are established, the genuineness of the transaction is also not in doubt, as the party has confirmed. The transaction was carried out through banking channels by way of foreign direct remittance. Then, such amount cannot be deemed as unexplained since the assessee has not got the approval from the competent authority to accept foreign direct remittance. As such, it may violate the RBI Act, which is independent of the Income-tax Act. But the violation of certain other statutes cannot be used to infer that the amount received as loan represents unexplained cash credit and deemed income of the assessee under the provisions of section 68.

Since the assessee discharged his onus cast under section 68, the additions made by AO must be deleted.