

IN THE HIGH COURT AT CALCUTTA  
SPECIAL JURISDICTION (INCOME TAX)  
ORIGINAL SIDE

ITA/8/2012

SK. JAYNAL ABDDIN  
VERSUS  
COMMISSIONER OF INCOME TAX, KOLKATA-XVI

BEFORE :

THE HON'BLE JUSTICE SURYA PRAKASH KESARWANI  
AND  
THE HON'BLE JUSTICE RAJARSHI BHARADWAJ

Date : 2<sup>nd</sup> April, 2024.

Appearance:

*Mr. J. P. Khaitan, Senior Advocate*  
*Ms. Anupa Banerjee, Advocate*  
*Mr. Sourav Chunder, Advocate*  
*Mr. P. Sharma, Advocate*  
*... for the appellant.*

*Ms. Smita Das De, Advocate*  
*Mr. Prithu Dudheria, Advocate*  
*... for the respondent.*

1. Heard Sri J. P. Khaitan, learned senior advocate assisted by Smt. Anupa Banerjee, learned counsel for the appellant/assessee and Smt. Smita Das De, learned standing counsel for the respondent/Income Tax Department.
2. This appeal was admitted by this Court by order dated 25.01.2012 on the following substantial question of law:

*“Whether the Tribunal was justified in law in judging the applicability of Section 40A(3) of the Act with reference to the lump sum amount paid to the leader of each group of workers for the purpose of disbursement to the individual workers on the appellant’s behalf and not with reference to the payment made to each individual worker and in holding that the group leader was the appellant’s sub-contractor or that the individual workers worked not under the appellant but under such group leader and its purported findings in that behalf are arbitrary, unreasonable and perverse ?”*

**Facts:-**

3. Briefly stated facts of the present case are that the appellant/assessee is engaged in business of embroidery and stitching. The assessee paid a sum of Rs.1,21,49,190/- for payment to labourers. According to the assessee, the aforesaid amount was paid to labours through supervisors who were employees of the assessee. The assessee used to draw a lump sum amount from bank by cheque through his employees i.e., supervisors for payment to be made to labours. The supervisors used to make payment to labours and give an account to the assessee in the form of a list containing payments made to each individual labour. In none of the cases, the payment so made by the supervisors to individual labour exceeded Rs.20,000/-. The assessing officer, while passing the assessment order dated 31.12.2008 for the assessment year in question i.e., 2006-07, invoked Section 40A(3) of the Income Tax Act, 1961

(hereinafter referred to as 'the Act, 1961') by recording the following facts :

*“The ground level labourers **were not subject to professional tax, ESI, PF, etc. There were no employer employee relationship with the assessee and the labourers.** The assessee simply got the work done by skilled labourers and the payment is ascertained on the basis of quality and quantity of the work done by them. The assessee in his submission dated 30.12.2008 further clarified that the job allotted to the worker are purely temporary. **Workers are paid some times for few month even for a few days. Thus the labour welfare measures are not take up nor it is particable.** These workers are quite illiterate, partly homeless and fast changing the employer and work on piece rate on the condition on no work no pay.*

*It is therefore inferred that the assessee could not produce satisfactory explanation for violation of the Provision of sec. 40A(3). 20% of Rs.12149191/- that is Rs.2429838/- is therefore disallowed. U/S 40A(3).”*

4. Aggrieved with the aforesaid assessment order, the appellant/assessee filed an appeal No.261/CIT(A)-XXX/Circle-48/2008-09 which was allowed by order dated 03.05.2010. The CIT(A) has recorded the following finding of fact:

*“I have carefully gone through the assessment order and explanation given by the appellant. The A.O. has stated that the payments to the Supervisor workers are in excess of Rs.20,000/- in cash for which he has disallowed the expenses in terms of section 40A(3) of I.T. Act. It has already been held in the preceding paragraphs that the so called sub-contractors are actually Supervisor worker and employees of the appellant firm. The payments made to*

them are meant for disbursement amongst the workers. It would be seen from the labour sheets that no single payment to the worker exceeds Rs.20,000/- in cash. **The practice followed by the appellant is to withdraw the aggregate amount of labour charges from bank and to disburse the same amongst the individual workers through the Supervisor. In not a single case, the individual payments to each worker ever exceed Rs.20,000/- as would be seen from the monthly pay sheet and wage summary sheet. I have gone through the case laws relied on by the appellant in the case of CIT vs. Aloo Supply Co. and CIT vs. Triveni Prasad Pannalal, cited supra, where the Hon'ble High Courts held that the statutory limit u/s. 40A(3) applies to payment made to the party at a time and not to the aggregate of the payments made to a party. Considering the totality of the facts and circumstances and having regard to the case laws cited above, it is held that the disallowance u/s. 40A(3) made by the A.O. is not called for. Accordingly, the addition of Rs.24,29,838/- is deleted.”**

5. Aggrieved with the order of the CIT(A), the revenue filed an appeal being ITA No.1647/Kol/2010 (A.Y. 2006-07) which was allowed by the ITAT by the impugned order. On the aforesaid issue the ITAT has recorded the following finding to hold that the supervisors are nothing but sub-contractors of the assessee.

**“We observe that assessee with each of above so-called supervisors ledger account has enclosed the copies of weekly work sheet showing the name of worker, inter alia, amount paid to each of them. However, on the top of the said work sheet, name of the said supervisor is stated. It is observed that assessee was making lumpsum payment on an adhoc basis for the purpose of further disbursement to workers and not as per the amount payable**

*by them to individual workers. We also observe from each of the page of ledger account placed in paper book (supra) that there is a closing balance. Had these supervisors been merely an employee of assessee along with the other workers, we are of the considered view that there was no question of any closing balance as on 31.03.2006. If assessee had made the payments to them for the purpose of further disbursement, assessee would have paid the amount to the so-called supervisors the amounts which were actually payable to them. However, this is not the case. Considering the entries in the ledger account, it fortifies the views of Assessing Officer that so-called group leaders or supervisors are nothing but sub-contractors of assessee and the workers whose names are mentioned in the work sheet to whom the payments were made through respective so-called group leaders, who were working not under the assessee but under the said so-called group leader.”*

6. Aggrieved with the aforesaid order of the ITAT dated 12.08.2011 in ITA No.1647/Kol/2010, the appellant/assessee has filed the present appeal.

**Submissions:**

7. Learned senior advocate for the appellant/assessee submits that the supervisors were the employees of the assessee. The payments to be made to labours were withdrawn by the assessee from bank through the supervisors for disbursement to individual labours and the supervisors, after disbursement, gave an account in the form of a list of payments made to individual labours. Payments so made to individual labours in no case exceeded Rs.20,000/-. Non-payment of EPF or PF is

not relevant for the purposes of Section 40A(3) of the Act, 1961. The supervisors acted as agent of the assessee and, therefore, the payments made to labours is payment made by the assessee which in no case exceeded Rs.20,000/- to any individual. Therefore, Section 40A(3) of the Act, 1961 is not attracted and the assessee's case is covered by proviso in Rule 6DD(l) of the Income Tax Rules, 1962.

8. Learned standing counsel for the respondent/department supports the impugned order of the Tribunal.

**Discussion and Finding:-**

9. We have carefully considered the submission of learned counsel for the parties and perused the paper book. Before we proceed to examine the rival submissions of learned counsel for the parties, it would be appropriate to reproduce Section 40A(3) of the Act, 1961, Rule 6DD(l) of the Income Tax Rules, 1962 and Sections 182, 185, 186, 188 and 211 of the Indian Contract Act, as under :-

***Income Tax Act, 1961***

**40A.** (3) *Where the assessee incurs any expenditure in respect of which payment is made, after such date (not being later than the 31<sup>st</sup> 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 [twenty thousand] rupees otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, [twenty per cent of 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 1<sup>st</sup> 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 [twenty thousand] 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 [Assessing] Officer may recompute 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 payment in a sum exceeding [twenty thousand] 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.]

#### **Income Tax Rules, 1962**

**6DD. No disallowance** under sub-section (3) of section 40A shall be made where any payment in a sum exceeding [twenty thousand] 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) . . .

. . .

***(l) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;***

**Contract Act**

**182. “Agent” and “principal” defined.-** An “agent” is a person employed to do any act for another, or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called the “principal”.

**185. Consideration not necessary.-** No consideration is necessary to create an agency.

**186. Agent’s authority may be expressed or implied.-** The authority of an agent may be expressed or implied;

**188. Extent of agent’s authority.-** An agent, having an authority to do an act, has authority to do every lawful thing which is necessary in order to do such act.

*An agent having an authority to carry on a business, has authority to do every lawful thing necessary for the purpose, or usually done in the course, of conducting such business.*

**211. Agent’s duty in conducting principal’s business.-** An agent is bound to conduct the business of his principal according to the directions given by the principal, or, in the absence of any such directions, according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and if any profit accrues, he must account for it.”

10. On perusal of the assessment order, we find that the assessing officer has not disputed the specific case of the appellant/assessee that the supervisors are his employees. The specific stand of the

appellant/assessee that the supervisors are his employees, was supported by books of account which were before the assessing officer. The assessing officer recorded the finding that since the provision of ESI, PF etc. were not followed by the assessee, therefore, the individual labours are not employees of the assessee. The assessing officer nowhere disputed the stand of the assessee supported by books of account that the supervisors are employees of the assessee. In paragraph 11 of the impugned order the ITAT recorded a finding based on surmise and presumption that the supervisors are nothing but sub-contractors of the assessee. This finding is perverse inasmuch as firstly it is not supported by any evidence and secondly it is contrary to evidence on record in the form of books of account that the supervisors are the employees who have been paid salary. Therefore, the finding recorded by the ITAT in the impugned order that the supervisors are sub-contractors, is perverse and is hereby set aside.

11. Section 40A(3) of the Act afore-quoted, as it stood at the relevant time, clearly provides by the second proviso that no disallowance under this sub-section shall be made, where any payment in a sum exceeding Rs.20,000/- 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. **Circumstances as referred in the aforesaid second proviso to Section 40A(3) of the Act, 1961 have been prescribed in Rule 6DD of the Income Tax Rules, 1962.**

Rule 6DD(1) clearly provides that no disallowance under sub-section (3) of Section 40A shall be made where any payment in a sum exceeding twenty thousand rupees is made otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft in the cases and circumstances **where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person.** Supervisors of the assessee acted as “agent” of the assessee. The word “agent” and “principal” has been defined in Section 182 of the Indian Contract Act. An agent is a person employed to do any act for another, or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called “principal”. Undisputed facts of the present case are that the appellant withdrawn amount from his bank account through his employees i.e., supervisors for disbursement to individual labours and the supervisors gave an account of the money so received for payment to labours. Thus, the appellant/assessee is principal and supervisors acted as agent of assessee. It is settled law that an authority of an agent may be express or implied. Submission of account by a supervisor acting as agent of the assessee, for the amount received and disbursed to individual labourers, leaves no manner of

doubt that the supervisors who were employees of the assessee, acted as agent of the assessee for the purposes of disbursement of amount to labourers. The payment so made by the supervisors had not exceeded Rs.20,000/- to any individual labour. As per provision of Section 211 of the Indian Contract Act, agent is bound to conduct the business of his principal according to the direction given by the principal or in the absence of such direction according to the customs which prevail in doing business of the same kind at the place where the agent conducts such business. In the present set of facts the supervisors acted as agent of the assessee in conducting the assessee's business. There is no material or evidence of record to indicate or establish that the supervisors were sub-contractors. Under the circumstances, the finding recorded by the ITAT that the supervisors were sub-contractors is perverse and contrary to law. Consequently, the said finding is hereby set aside.

12. We have found that the supervisors acted as agent of the assessee to disburse the amount to individual labours which in no case exceeded Rs.20,000/- to any individual labour. Therefore, in view of the circumstances prescribed in the second proviso to Section 40A(3) of the Act, 1961 read with Rule 6DD(1) of the Income Tax Rules, 1962 and the above-referred provisions of the Indian Contract Act, the aforesaid payment of Rs.1,21,49,190/- cannot fall within the scope of Section

40A(3) of the Act, 1961. Consequently, the disallowance to the extent of 20% made by the ITAT and to add it in the income of the assessee cannot be sustained and is hereby set aside.

13. For all the reasons afore-stated, the impugned order of the ITAT to the extent it upholds the disallowance under Section 40A(3) of the Act, 1961 for Rs.24,29,838/-, cannot be sustained and is hereby set aside. Consequently, the substantial question of law is answered in favour of the assessee and against the revenue.
14. The appeal [ITA/8/2012] is **allowed to the extent indicated above.**

(SURYA PRAKASH KESARWANI, J.)

(RAJARSHI BHARADWAJ, J.)