CASH PAYMENTS UNDER INCOME TAX ACT, 1961

Description

From Demonetization to Digital India, the Government of India is trying to curtail the use of cash as a medium of transaction to other banking channels, aimed at creating a more transparent, efficient, and inclusive financial ecosystem by reducing the reliance on cash transactions in India.
The government is also imposing penalties, disallowances, and restrictions on cash transactions above certain thresholds to discourage the use of cash for high-value transactions. Let's discover some of transactions where one should not pay in cash to avoid tax and penalties under the Income-tax Act, 1961.
1. Health Insurance
Health insurance offers financial protection for unexpected medical expenses and hospital charges during times of need.
Section 80D: To incentivize individuals to buy health insurance plans, the government has provided tax advantages for medical insurance premiums through Section 80D. However, deduction under this section is not allowed if the medical insurance premiums and expenses are paid in cash except for preventive health checkup for which deduction is allowed up to 5,000 combined.
Section 36(1)(ib): This section allows businesses to deduct premiums paid by professionals or companies for the health insurance of their employees. However, this deduction is not permitted if the premium is paid in cash.
Note: In case of life insurance policies, deduction of premium paid will be allowed under Section 80C irrespective of the payment mode i.e., even cash payments are eligible for deduction when the default tax regime has been opted out.

2. Payment in a Single Day to a Single Person
Section 40A(3) is designed to combat tax evasion and the proliferation of black money within India. It states that tax deductions will not be allowed for payments exceeding 10,000 made to a person in a single day if they are made in cash.
The limit specified in Section 40A(3) is raised to 35,000 when cash payments are made to transporters for hiring, leasing, or operating goods vehicles. Additionally, up to Rs. 50,000 in cash can be paid as terminal benefits to employees.
However, there are certain exceptions to this section under Rule 6DD, for reference, payment to banks, book adjustments, etc.

3. Actual Cost of Asset
As per section 43(1), actual cost means the actual cost of assets to the assessee and this amount is added to the block of assets when any new asset is acquired. Where any expenditure for the acquisition of an asset for which payment or aggregate of payments made to a person in a single day exceeds Rs. 10,000 in cash, then such part of payments shall be ignored.
Taking an example, suppose Mr. Yash purchased a car for Rs. 2,00,000 for which he paid Rs. 20,000 in advance in cash in a single day and later on paid the remaining amount via NEFT. The actual cost on which Mr. Yash can claim depreciation would be only Rs. 1,80,000 and not Rs. 2,00,000 as 20,000 was paid in cash in a single day for the car.
4. Specified Businesses
Section 35AD of the Income-tax Act pertains to deductions available for specified businesses engaged in certain activities, such as setting up and operating cold chain facilities, warehousing facilities for storage of agricultural produce, among others, which are eligible for deduction for the whole amount of capital expenditure on assets incurred in the year of such expenditure rather than claiming depreciation on such expenditure over the years of useful life of such assets.
This investment-linked tax incentive is only allowed if the assessee opts out of the default tax regime under section 115BAC. This deduction is not allowed if the payments or aggregates of payments are made to a single person in a single day exceeding Rs. 10,000 in cash.

5. Loans or Deposit
Under Section 269SS, an individual cannot receive a cash loan or deposit of Rs 20,000 or more from another person within a single day. The penalty imposed by the assessing officer on the recipient of the loan or deposit can be up to 100% of the amount involved.
Likewise, under Section 269T, an individual is prohibited from repaying a loan or deposit in cash if the amount exceeds Rs. 20,000.
In clause 31 of Form 3CD of the Audit Report, the tax auditor is required to report transactions outlined in Sections 269SS and 269T. Both the payer and the receiver involved in these transactions are obligated to report them.
6. Donations to Political Parties
100% of taxpayer’s contributions to a registered political party or electoral trust can be claimed as a deduction. This provision incentivizes people to financially back the political system while reducing their tax burden by claiming deductions on such donations.
However, donations made in cash or kind to political parties or electoral trusts are not eligible for tax deductions under Sections 80GGB and 80GGC.
7. Presumptive Income Extended Limits
Section 44AD of the Income-tax Act provides a presumptive taxation scheme for certain eligible businesses (only resident individual, HUF, or firms), wherein they can declare their income at a prescribed rate without the need to maintain detailed books of accounts.
Under this section, eligible businesses with a turnover of up to Rs. 2 crores can opt to be taxed at a presumptive rate of 8% of their turnover (6% in case of digital transactions). This section aims to simplify the tax compliance process for small businesses by offering them a straightforward method of calculating their taxable income.
From the Assessment year 2024-25, the limit of Rs. 2 crores will be Rs. 3 crores if the aggregate amount received in cash during the previous year does not exceed 5% of the total turnover of such previous year. Even cheques and bank drafts which are not account payees shall be deemed to be receipts in cash. For example, if Mr. Yash has a turnover of Rs. 2.8 crores and if his cash sales do not exceed Rs. 14 lakhs, then he can take the benefits of Section 44AD.

8. Section 269ST
Section 269ST prohibits any individual from receiving an amount of Rs. 2 lakh or more in cash under the following examples and the penalty of an amount equivalent to the transaction amount will be charged:
Single Person in a Day: If Mr Yash sells goods totaling Rs. 3,00,000 through three separate bills of Rs. 1,00,000 each to one individual and receives cash payments on the same day at different intervals, it would result in a violation of Section 269ST(a).
Single Transaction: If goods valued at Rs. 3,00,000 are sold via a single bill and cash payments of Rs. 2,30,000 are received on day 1 and another Rs. 70,000 on day 2, then Section 269ST(b) would be breached.
Single Event: Accepting cash payments of Rs. 50,000 for catering, Rs. 80,000 for tent work, and Rs. 80,000 for decoration for Ram's wedding event by Shyam would violate Section 269ST(c) since all cash transactions related to the same event, regardless of the date of acceptance.
9. Conclusion
Nearly 65% of customers use cash to make payments in their online transactions. Despite an accelerated digitalization of payments in India, an online consumer behavior survey conducted by the Indian Institute of Management-Ahmedabad (IIM-A) recognized cash-on-delivery as the most preferred mode of payment for online purchases. Tax evasion poses a significant challenge in India and contributes to economic inequalities. Illicit cash transactions generate unrecorded funds, leading to a rise in tax evasion. The government of India has made certain provisions that outline certain transactions that business owners and taxpayers should avoid doing in cash to save themselves from penalties and additional taxes.

Category

1. Income Tax

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