

## Unexplained Cash Credit - The Litmus Test

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### Background:

Section 68 of the Income Tax Act, 1961 deals with unexplained cash credits. Where there are cash credits in the books of accounts and the Assessee has no explanation about the nature and source or the explanation offered in the opinion of the Assessing Officer is not satisfactory, the sum so credited may be charged to income tax as the income of the Assessee of that previous year. The tax and penalty impact is significant on account of the amendments made to Section 115BBE(1) and the introduction of Section of Section 271AAC by the Taxation Laws (Second Amendment) Act, 2016 w.e.f. 01.04.2017.

The emphasis has always been on establishing the nature of credits and the source. The whole issue has taken a new dimension on account of the recent decision of the Supreme Court in the case of **CIT Vs. NRA Iron & Steel Pvt. Ltd.** / [\[TS-106-SC-2019\]](#) in the context of monies received through share capital / share premium.

### The Journey:

Original return was filed disclosing an income Rs. 7.01 lakhs for the assessment year 2009-10. In the return filed pursuant to Section 148 notice, Rs. 17.60 crores was shown as received through share capital/ premium. The names of the Mumbai, Kolkata and Guwahati based investor companies were given. The shares had a face value of Rs. 10/- per share and were subscribed by the investor companies at Rs. 190/- per share.

The issue before the Assessing Officer was whether the amount of Rs. 17.60 crores identified as share capital/ premium was genuine or not. The explanation given by the Assessee was considered unsatisfactory for the following reasons.

(i)None of the companies which had invested amounts ranging between Rs. 90 to 95 lakhs could justify investments at such a high premium of Rs. 190/- per share.

(ii)Some of the companies were found to be non- existent.

(iii)Almost none of the companies produced bank statements to establish source of funds for making such a huge investment even though they were declaring meagre income in their returns.

(iv)None of the investor companies appeared in person but sent written response through mail.

The Assessing Officer for these reasons added the amount of Rs. 17.60 crores under Section 68. The first appellate authority granted relief by following the decision of the Delhi High Court in the case of **CIT v. Lovely Exports Ltd. (2008) 299 ITR 268 (Del.)**. The Tribunal dismissed the appeal of the Revenue on the ground that the Assessee had discharged their primary onus to establish their identity and credit worthiness of the investors, especially when the investor companies had filed their returns and were being assessed. The Delhi High Court agreed with the Tribunal and held that there was no substantial question of law.

### Supreme Court Decision dated 05.03.2019

On the SLP filed by the Revenue, where the assessee was not represented despite notice, the Supreme Court laid down three principles after analyzing various decisions with reference to treatment of sums of money credited as Share Capital/ Premium:

(i)The Assessee is under a legal obligation to prove the genuineness of the transaction, the identity of the creditors, and the credit worthiness of the investors who should have had the financial capacity to make the investment in question, to the satisfaction of the AO, so as to discharge the primary onus.

(ii)The assessing officer is duty bound to investigate the credit-worthiness of the creditor/ subscriber, verify

the identity of the subscribers, and ascertain whether the transaction is genuine, or there are bogus entries of name- lenders.

(iii) If the enquiries and investigations reveal that the identity of the creditors to be dubious or doubtful, or lack credit worthiness, then the genuineness of the transaction would not be established.

The Supreme Court applied the aforesaid principles to the facts and concluded that:

(i) There was no material to prove or to suggest that the share money was received from independent entities. The genuineness of the transaction was found to be completely doubtful.

(ii) The investor companies had filed returns for a negligible taxable income which would show that the investors did not have the financial capacity to invest funds ranging between Rs. 90 to Rs. 95 lakhs.

(iii) There was no explanation offered regarding why the investor companies had applied for shares of the Assessee company at a high premium of Rs. 190/- per share, even though the face value of the share was Rs. 10/- per share.

(iv) The investor companies did not establish their source of funds from which the high share premium was invested.

(v) The mere mention of the income tax number of an investor was not sufficient to discharge the onus under Section 68 of the Act.

In Para 15 of the decision, the Supreme Court has observed as under:

*"The practice of conversion of un-accounted money through the cloak of Share Capital/ Premium must be subjected to careful scrutiny. This would be particularly so in the case of private placement of shares, where a higher onus is required to be placed on the Assessee since the information is within the personal knowledge of the Assessee. The Assessee is under a legal obligation to prove the receipt of share capital/ premium to the satisfaction of the AO, failure of which, would justify the addition of the said amount to the income of the Assessee."*

Lovely Exports Case:

The Assessee did not represent through counsel before the Supreme Court even after a couple of adjournments. While the first appellate authority had relied upon the Delhi High Court Decision in the case of **CIT v. Lovely Exports Ltd. (2008) 299 ITR 268 (Del.)** / [\[TS-85-SC-2008\]](#) which was subsequently maintained by the Supreme Court, there is no discussion about this decision. In the said decision, the Delhi High Court had observed that a delicate balance must be maintained while walking the tight-rope of Sections 68 and 69 of the Income Tax Act. The burden of proof can seldom be discharged to the hilt by the Assessee; if the Assessing Officer harbours doubts of the legitimacy of any subscription, he is empowered, nay, duty bound to carry out thorough investigations. But if the Assessing Officer fails to unearth any wrong or illegal dealings, he cannot obdurately adhere to his suspicions and treat the subscribed capital as undisclosed income.

The Delhi High Court had held that the following factors would be relevant:

(i) *The identity of the creditor/ subscriber;*

(ii) *The genuineness of the transaction, namely, whether it has been transmitted through banking or other indisputable channels;*

(iii) *The creditworthiness or financial strength of the creditor/ subscriber;*

(iv) *If relevant details of the address of PAN identity of the creditor/ subscriber are furnished to the Department along with copies of the shareholders' register, share application forms, share transfer register, etc., it would constitute acceptable proof or acceptable explanation by the Assessee*

(v) The department would not be justified in drawing an adverse inference only because the creditor or the subscriber fails or neglects to respond to its notices;

(vi) *The onus would not stand discharged if the creditor/ subscriber denies or repudiates the transaction set up by the assessee nor should the Assessing Officer take such repudiation at face value and construe it, without more, against the assessee; and*

*(vii)The assessing officer is duty bound to investigate the creditworthiness of the creditor/ subscriber the genuineness of the transaction and the veracity of the repudiation.”*

While dismissing the SLP filed by the Revenue, the Supreme Court in the case of **CIT Vs. Lovely Exports Pvt. Ltd. (2008) 216 CTR 195** observed that:

*“Can the amount of share money be regarded as undisclosed income under section 68 of IT Act, 1961? We find no merit in this Special Leave Petition for the simple reason that if the share application money is received by the assessee company from alleged bogus shareholders, whose names are given to the AO, then the Department is free to proceed to reopen their individual assessments in accordance with law. Hence, we find no infirmity with the impugned judgment.”*

#### Open Issues:

1. Given the fact that the decision in the case of Lovely Exports has not been distinguished or referred to in the NRA Iron & Steel case, would the matter go to the Larger Bench in the future?

2. The Supreme Court, however, has referred to the Delhi High Court decision in the case of **Pr. CIT Vs. NDR Promoters Pvt. Ltd. (2019) 410 ITR 379** / [\[TS-5023-HC-2019\(DELHI\)-O\]](#) which had in fact followed the earlier decision in **CIT Vs. Navodaya Castles Pvt. Ltd. (2014) 367 ITR 306**/ [\[TS-6179-HC-2014\(DELHI\)-O\]](#) which had referred to the observations of the Supreme Court while dismissing the SLP in the case of Lovely Exports. Whether this would be considered as taking note of the decision or whether the decision should be considered as per incuriam is a matter of debate.

3. The Supreme Court has also referred to its own decisions in the case of **Sumati Dayal Vs. CIT (1995) 214 ITR 801** / [\[TS-5013-SC-1995-O\]](#) and **CIT Vs. P. Mohankala 291 ITR 278** in the context of burden of proof. This by itself can be significant since the entire issue revolved around burden of proof.

4. Finance Act, 2012 had amended Section 68 to insert a Proviso to provide that in respect of share application money, share capital or share premium, the explanation offered shall be deemed to be unsatisfactory unless the other person also offers an explanation about the nature and source of the sum and such explanation in the opinion of the Assessing Officer is satisfactory. The assessment year in the case of **NRA Iron & Steel is 2009-10** / [\[TS-106-SC-2019\]](#) and the Proviso to Section 68 as introduced by Finance Act, 2012 was not brought to the notice of the Supreme Court. The Bombay High Court in the case of **CIT Vs. Gagandeep Infrastructure** [\[TS-132-HC-2017\(BOM\)\]](#) had held that the Proviso relating to share premium is prospective. *Whether the same view would have been expressed if the proviso was also examined given the fact that the assessment year involved is prior to the amendment is a matter of debate.*

5. It is also relevant to note that the Delhi High Court in the case of **CIT Vs. Dwarkadhish Investment Pvt. Ltd. (2011) 330 ITR 298** / [\[TS-5547-HC-2010\(DELHI\)-O\]](#) had observed that the SLP against the Division Bench judgment was dismissed by the Supreme Court by a speaking order in **Lovely Exports**. The High Court observed that consequently, the doctrine of merger would apply and the judgment of the Supreme Court in **Lovely Exports** would cover the field. *Whether doctrine of merger is applicable or not can be a matter of debate since the Supreme Court did not grant leave in the said case.*

6. In the case of **CIT Vs. Stellar Investments (1991) 192 ITR 287** / [\[TS-20-HC-1991\(DEL\)\]](#), the Delhi High Court held that there is no question of law when the Tribunal had held that even if it is assumed that the subscribers to the increased share capital were not genuine, nevertheless, under no circumstances can the amount of share capital be regarded as an undisclosed income of the assessee. The Delhi High Court's decision was agreed with by the Supreme Court in the case of **CIT Vs. Stellar Investments Pvt. Ltd. (2001) 251 ITR 263**. In the NRA case, this decision has not been considered.

7. Recently, the issue of share premium, share valuation, start-up companies, angel investments are all in the news for many number of reasons and a number of changes have also been made by the Government to ensure that genuine transactions are not affected. *This decision in the context of share premium with reference to Section 68 will have a bearing on many matters.*