

Unexplained/Undisclosed Income/Assets

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DIRECT TAX REFRESH COURSE
WIRC – Mumbai – 8th June, 2019







Changing Landscape

Lovely Exports Pvt. Ltd. [2008] 299 ITR 268 (Delhi)

SLP Rejected [2009] 319 ITR 5

To

PCIT Vs. NRA Iron and Steel Pvt. Ltd. [2019] 412 ITR 461 (SC)

[Demonetization (8th Nov 2016), outbursts of the Government, incessant actions against black money – say even from optics perspective]

Does it have an impact on moulding judicial opinion?



Cash Credits



Cash Credit – Section 68

- Any sum found to be credited in the books of an assessee
 - Credited
 - In the books of an assessee
- Assessee offers no explanation or the explanation offered by him is not satisfactory
- About the nature and source thereof
- May be charged to income-tax as income of the Assessee
- By Finance Act, 2012 (w.e.f. 1.4.2013)
 - Share application money, share capita, share premium or any amount by whatever name called received by a closely held company, even the investor need to explain the nature and source of the amount so credited (*in the books of the Assessee Company*)



Section – 115BBE (A.Y. 13-14 onwards)

- If the income referred to in sections
 - 68 - cash credit,
 - 69 - unexplained investment,
 - 69A - unexplained money, etc.,
 - 69B - amount of investment, etc. not fully disclosed in books of accounts,
 - 69C - unexplained expenditure, etc.; and
 - 69D - amount borrowed or repaid on hundi
- (Even) if reflected in the return of income filed U/s. 139 – tax at the rate of 60 % + (effective 71.76% including Cess & SC) (w.e.f. AY 17-18)
- No deduction for any expenditure, allowance or (*from AY 17-18*) set off of any losses
- If not reflected in the return U/s. 139 (and tax paid thereon) then penalty of 10 % of the tax U/s. 271AAC
- No penalties U/s. 270A



Transactions covered

- Loan / Gift Transactions – Gifts – though offered U/s. 56 (2) (x)
- Share Application Money / Share Subscription Money, Share Premium etc.
 - Prevalent practice of subscribing at high premium and then buying back at face value also Claim of losses.
 - Section 56 (2)(viib) and 56 (2) (x)
- Penny Stock – Capital Gains – Listed Securities
 - Purchase shares through stock exchange at a very low price
 - Sell it off at a very high price through stock exchange after it becomes Long Term Asset
 - Claim capital gains exemption for profit / the seller at stage 1 claims business loss
- Even booking bogus sales / “on money” can be re-classified as Cash Credit and Section 115BBE can be attracted
 - Counter sales in case of a shop say selling antiques / arts / designer clothing / jewellery
- Deposits in Bank Accounts [Section 68 / 69]
- Donations not covered by 115BBC (even 115BBC donations can be covered for rate purposes]



Historical Background

- Sreelekha Banerjee 49 ITR 112 (SC)
 - Even where there was no corresponding provision to section 68 in 1922 Act, it was held that the amount credited in the books can be treated as income if the Assessee fails to offer an explanation
- Orissa Corporation 159 ITR 78 (SC)
 - Most used decision for CC
 - Concept of Primary Onus and shifting of burden of proof
 - Year of taxability being the difference between codified law (Section 68) and earlier period
- The concept of “Source of Source”
 - S. Hastimal 49 ITR 273 (Mad)
 - Tolaram Daga 59 ITR 632 (Assam)
 - Daulatram Rawatmull 87 ITR 349 (SC)
 - Sarogi Credit Corporation 103 ITR 344 (Pat)



Nature of the Burden

- Three conditions to be satisfied to discharge the Onus
 - Identity of the Creditor
 - Genuineness of the Creditor
 - Creditworthiness of the Creditor
- Identity of the Creditor is generally not an issue
 - Confirmation of the Creditor
 - Address
 - PAN / GIR No.
 - Transaction through Bank
- Genuineness of transaction and Creditworthiness of Creditor
 - Changing Scenario



Judicial View till recently

- Roshan Di Hatti 107 ITR 938 (SC) / Kale Khan Mohammad Hanif 50 ITR 1 (SC)
 - Onus to prove the source of money credited on the Assessee
 - No burden on Department to prove the particular source of income if the assessee fails to prove the source
- Even where the share application money is received from bogus shareholder, the department cannot add in the hands of the Company, they can proceed to tax the sum in the hands of the shareholder
 - Lovely Exports P Ltd. [2008] 216 CTR (SC) 195
 - Steller Investment Ltd. [2001] 251 ITR 263 (SC)
- For Share application money, even if the investor is not having means to make investment, the department has to prove that the investment actually came from the coffers of the Company
 - Value Capital Services P. Ltd. [2008] 307 ITR 334 (Delhi)
- Sophia Finance Ltd. [1993] 205 ITR 93 (Delhi)(FB)
 - Reiterating the view expressed in Stellar Investment.- High Court
- Divine Leasing [2008] 299 ITR 268
 - In Share Application, the AO must prove that the investors were benamidars / fictitious persons / represented company's own income from undisclosed sources.



Impact of these Decisions

- Taking bogus loan entries changed to Share Application Money
- Rampant Practice of Share Application Money whether (at premium or otherwise) and practically no addition would be sustained.
- In case of Share Application Money
 - Name and Address of the Shareholders
 - Share Application Form
 - Copies of the Share Certificates
 - Confirmation with PAN and basic source of investment
 - Transaction details like cheque number, etc.
 - If the shareholder maintains accounts then reflection in the books of the said shareholder
- Penny Stock transactions are also by-product of this, clubbed with introduction of exemption of LTCG on listed shares
- To curb these practices introduction of 56 (2) (x) / 56 (2) (viib)



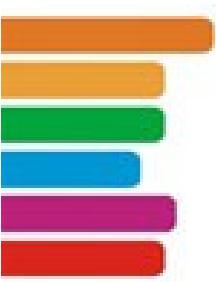
NRA Iron and Steel Pvt. Ltd.

- A major shift in the approach to the matter of share application money
 - Cash of Share investment at high premium
 - Genuineness of the transaction is looked upon from different angle
 - Sumati Dayal [1995] 214 ITR 801 (SC) applied
- The Investors satisfied the following
 - Identity proved by Name, Address, Confirmation, PAN, IT Records, Bank Records, etc. etc.
 - Financials of the Investors duly reflected the investment
 - Transactions through Banking Channels
 - Some of the Investors also confirmed directly in response to enquiry
- Adverse Findings
 - Negligible taxable income of the investors
 - Some of the investors were not found at the address
 - Reasons for high premium could not be explained
- Stress is on genuineness of the transaction considering the overall circumstances.



NDR Promoters [2019] 410 ITR 379 (Delhi)

- *Excellent Paper Work* was ignored
 - Holding the transaction to be sham and make believe
 - Paper work to camouflage the bogus nature of the transaction
 - Reasoning given is contrary to human probabilities
 - No one will make such huge investment without being concerned about its safety and return
- In this case the surrounding circumstances showed that the share application money were nothing but accommodation entries.
 - Though the creditors confirmed, the amount reflected in the books, bank entries were shown, etc. etc.
 - Reliance on the decisions of Durga Prasad More 82 ITR 540 (SC) and Sumati Dayal
 - The taxing authorities were not required to put on blinkers while looking at the documents produced before them. They were entitled to look into the surrounding circumstances to find out the reality of the recitals made in those documents.



Is Judiciary taking note of inherent dishonesty?



Penny Stock – Some Decisions

- Meghraj Singh Shekhawat vs. DCIT in ITA Nos.443 & 444/JP/2017 (Jaipur Tribunal)
 - Relied upon by Mumbai Tribunal in case of Ramprasad Agrawal ITA 4843 & 1228/Mum/2018
 - Allowed the penny stock matter in favour of the Assessee
 - Original Allotment and then sold at a premium
 - Merely because a middle man confessed cannot be the ground
 - All the transactions proved including the de-mat account entries and bank entries for payments
- Some other decisions in favour Jamnadevi Agarwal 328 ITR 656 (Nag); Anupam Kapoor 299 ITR 179 (P&H)
- Shyam R. Pawar 54 Taxmann.com 108 (Bom) – No further enquiry by department, mere suspicion cannot be ground for rejection of evidence on record.
- Saurabh Mittal ITA 16/JP/2018 – Off Market Purchase – Merger, SEBI Order revoked – Mere adverse statements by promoters – No Cross Examination, etc. – Decided in favour
- Rajkumar Agarwal ITA 1648&1649 /PUN/2015
 - Against the Assessee – Penny Stock
 - SEBI tainted entity / middleman
- Sanjay Bimalchand Jain 89 Taxmann.com 196 (Bom) – No SQL (in favour of department) – Significant increase in the price not supported by evidence



Present View

- Genuineness is the main focus
 - Surrounding Circumstances and the AO needs to sit back and ask “whether this is believable” irrespective of documents showing everything in order
- Penny Stock Cases
 - DI Kolkatta’s 24.7.2015 Investigation Report revealing Rs. 38,000 Cr Scam & SEBI’s famous List of 331 Listed Companies
 - Tainted Brokers
 - Search / Survey / Admission by brokers or counter parties
 - Unusual movement in the stock
 - Off market transactions
- Cash Credits
 - Capacity to be proved by several factors and not only by entries in the books of accounts.
 - Known Hawala Operators
- Share Premium
 - Justification of Share Premium – Valuation Report with supporting subsequent performance



Other Issues connected with Section 68

- Use of the word “May”
 - P. K. Noorjahan [1999] 237 ITR 570 (SC) / Rohini Builders [2002] 256 ITR 360 (Guj) SLP Dismissed by SC
 - Inability to satisfactorily explain the source does not result into automatic addition
 - Instances of inability is due to bona fide reasons – Disputes
 - First day of a Company or no business, etc. [Section 68 Vs. 69]
- In the “Books” of the Assessee
 - Loose Papers where credits are mentioned - CBI Vs. V. C. Shukla [1998] 3 SCC 410
 - If used to explain the source – Reconstruction – then would amount to “Books”
 - Passbook is not books of accounts – Bhaichand H. Gandhi 141 ITR 67 (Bom)
- Amount credited to the capital account of the partners
 - More appropriate to add in the hands of the Partner U/s. 69



Other issues Contd

- Cash Sales / Gifts taxable U/s. 56 (2) (x) / Sales against DD
 - AO can still invoke Section 68 and apply higher rate of tax if source not satisfactorily explained
 - Could be very harsh in some cases
- Rejection of Books
 - If the books are rejected in a wholesome manner and profits/ income estimated then addition U/s. 68 may not be right
 - Kale Khan Mohammed Hanif 50 ITR 1 (SC) – Both can be added i.e. by estimating the business income and rejecting the books and also cash credits U/s. 68 found credited in the same books
 - Maduri Rajaiahgari 120 ITR 294 (AP) – If the cash credits are referable to the business income which is estimated by rejecting the books then no separate addition should be made. However, cash credits unconnected with business then addition can be made
 - Primary requirement is that the books should be accepted by the AO



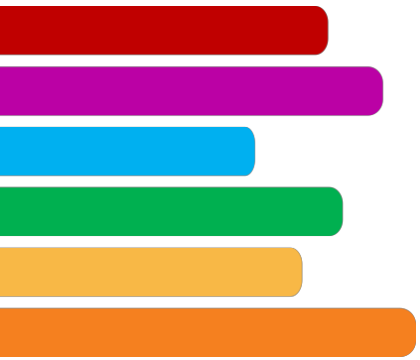
Cash Credits... Other Issues .. contd

- If Intangible Additions (say by estimating profits / bogus purchases, etc.) made can be used for explaining cash credits
 - Intangible additions offered to buy peace or avoid litigation
 - Impact on the Penalty – If earlier year's intangible addition used
 - For periods prior to A.Y. 2017-18 – Explanation 2 to Section 271 (1)
 - After AY 2017-18 – Section 270 A (4)
 - Impact on the Penalty – If current year's intangible addition set off
 - May amount to admission unless carefully handled
- Concept of Peak Credit
 - Cases where there are several cash credits (especially in cases of Shroffs / Money Lenders) including in cases of search
 - Peak Credit can be the applied in a proper case – Jhamatmal Takhatmal Kirana Merchants 152 CTR (MP) 311
 - Bherumal C. Jain (Mumbai ITAT) – Distinction between admitted CC Vs. Unexplained CC – Bhaiyalal Shyam Bihari 276 ITR 38 (All)
 - D. K. Garg – Delhi High Court - a case of self confessed entry provider



Angel tax controversy

- Section 56 (2) (viib) and “Angel Tax”
 - Applies only to consideration for issue of shares
 - By “a closely held company”
 - Investor being a resident (including NOR)
- Exemption given:
 - Venture Capital Undertaking from a VC Company or VC Fund
 - By a company from notified person or class of persons
 - Notification dated 14.6.2016 – Exempting Persons making investment in a “start up” as defined in the start up notification of DIPP No. GSRI 80 (H) dated 17.2.2016
- Genuine “Angel Investment” could still face trouble as all may not qualify to be a “start up”.



Unexplained Investment



Section 69 / 69 A

- Section 69
 - Assessee has made **investment**
 - **Not recorded** in the books of account; and
 - The assessee offers **no explanation** about the nature and source of the investments or the **explanation offered** by him **is not**, in the opinion of the AO **satisfactory**
 - **Value of the investment** may be deemed to be the income
- Section 69 A
 - Assessee is found to be the owner of any money, bullion, jewellery or other valuable article
 - Rest of the conditions are same with S. 69



Cases Covered

- Would cover the following cases
 - All AIR enquiry cases / FIU / third party search / Investigation
 - Cash Deposits – Post demonetization
 - Search and Seizure
 - Cash Seized, Jewellery, bullion, paintings, sculptures, investments, etc. found
 - Agreement to Sale / purchase documents found
 - De-mat Accounts found
 - Investment in partnership by the Partner or Investment in shares by a major shareholder / family member in a company
 - Benami Transactions
 - Life Insurance Policy Premiums
 - Excess Stock
- Would not cover the cases of undervaluation where part of the value is disclosed – S 69 B covers such cases



Burden of Proof

- Initial Burden to prove the nature and source of investment is on the Assessee
 - In search cases, the principles of source and application can be adopted
 - If information about the income (say “on money”) is found or admission is made for additional income, the same can be used for explaining the source of investment
 - Proximity of the dates very relevant
 - Nexus between earning of the income and the investment may also be necessary
 - Can also be explained out of earlier year’s income
 - Inheritance / Wills / Gifts, etc.
 - For Stock – On approval, third party stock for job-work, consignment, bailee, etc.
- Growing sources of information with the Government and chances of investment going out of sight are reducing



Value of the Investment / other assets

- Fair Value – Manner of Determination
 - 11UA Valuation
 - Stamp Duty Value for the immovable properties
 - Date of valuation for jewellery in non-operating Locker
- Presumption U/s. 132 (4A) / 292C
 - Any money, bullion, jewellery or other valuable article or thing are or is found to be in possession **or** control of any person in the course of a search (or survey), it may be presumed – that such money, bullion, jewellery or other valuable article or things belongs to such person.
 - 132 (4A) presumption only against such person and not any other person
 - Rebuttable presumption – SMS Investment Corporation [1988] 173 ITR 393 (Raj)



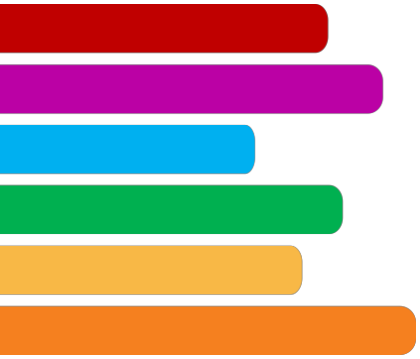
Investment, etc. not fully disclosed



Section 69 B

- Fundamental difference between 69 / 69A and 69B
 - Not recorded in books Vs. Partially recorded in the books
 - AO finds
 - the amount expended exceeds the amount recorded
 - The assessee offers **no explanation** about **the excess amount** or the **explanation offered** by him **is not**, in the opinion of the AO **satisfactory**
- No concept of value but the basis is amount expended
- Therefore cases of estimate about cost of construction, undervaluation (stamp duty), etc out of the purview – Dinesh Jain Lata Jain [2013] 352 ITR 629 (Del)
- Initial Onus here is on the AO where he has to show:
 - He has found
 - Amount expended is in excess

Smt. Amar Kumari Surana [1997] 226 ITR 344 (Raj)
Puneet Sabharwal [2011] 338 ITR 485 (Del)
- Cases of Mere valuation difference would be covered only by Section 56 (2) (x) if at all.

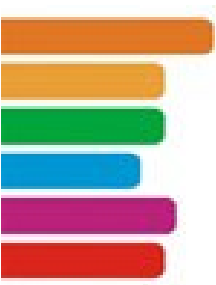


Black Money Act

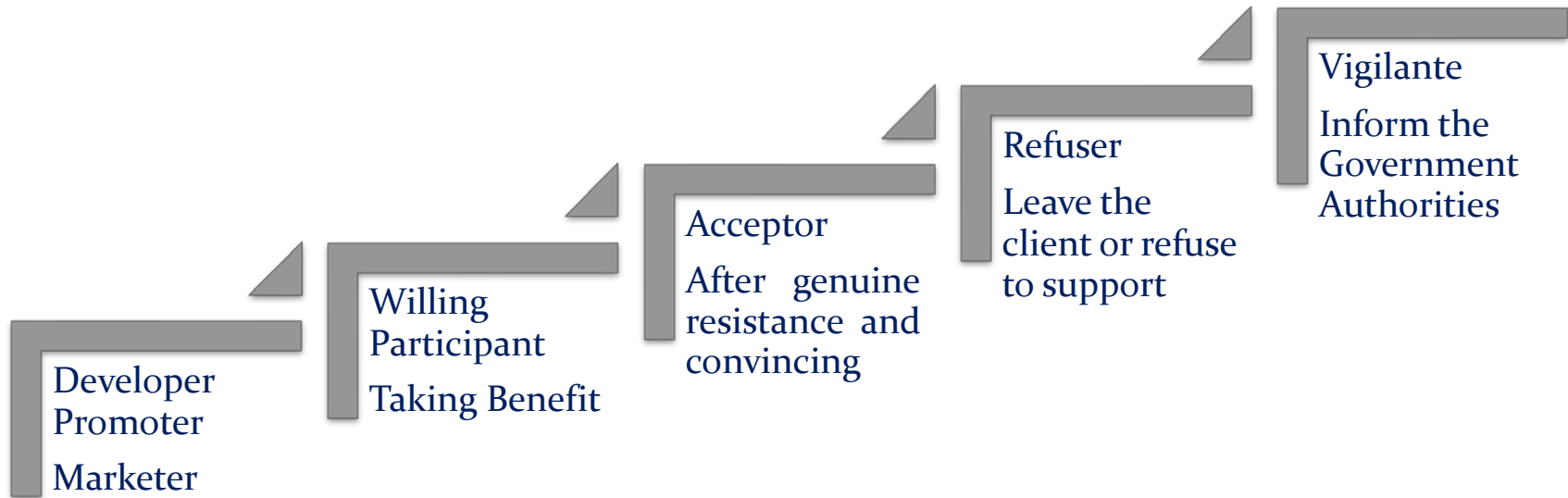


Snippets of Black Money Act

- Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 [BMA] effective from 1st July, 2015
 - Controversy about the effective Date
- Applies only to ordinary residents
- Concept of Retrospectivity
 - Proviso to Section 3 (1) – Applies only to Undisclosed foreign asset
 - Foreign Asset acquired out of undisclosed foreign income need not necessarily become undisclosed foreign asset
 - UFA means the asset located outside India acquired out of the source for which the Assessee does not have any explanation or the explanation is not found to be satisfactory by the AO
 - UFI means the income from the sources outside India which has not been disclosed / assessed under the ITA
 - Therefore, the foreign assets which are acquired out of sources which are explained (say foreign commission from identified source) but on which IT, though payable is not paid would be taxed in the respective year.
 - If such income therefore is for A.Y. 2015-16 or earlier, it would be taxed under ITA and not under BMA



In the context of a dubious scheme



Where do we stand?

Questions???

Thank You

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