

# Controversies

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Whether Share application/Share Capital money received by the company is covered by provisions of Sec. 68?

## Issue:

X Pvt. Ltd. has received an amount of Rs. 1 Crore as Share application money in A.Y. 2012-13 and X Ltd. Pvt. Ltd. Company has received Rs. 1 Crore as Share Capital money in A.Y. 2012-13. The AO is of the view that the share application money and Share Capital money is hit by Sec. 68 as the source of the money remains unexplained.

Assessee contends that Share application money and Share Capital Money is not covered by the provisions of Sec. 68 and cannot be taxed as income from undisclosed sources in the hands of the company.

## Proposition:

It is proposed that even if the Share Application money is not satisfactorily explained by the companies as well as if Share Capital money is not explained, no addition can be made u/s. 68 in the hands of the company.

## View against the Proposition:

It is submitted that onus is on the assessee to prove that the cash credit is genuine and cash creditor is a man of means on the issue of burden of proof a very specific and illustrious decision was from the Hon. Calcutta High Court in CIT vs. Precision Finance Pvt. Ltd. (1994) 208 ITR 465 (Ca I) where in it was laid down that the assessee is expected to establish:-

1. Identity of his creditors.
2. Capacity of creditors to advance money; and
3. Genuineness of transaction.

Where any sum is found credited in the books of the assessee for any previous year it may be charged to Income Tax as the income of the assessee for that previous year if the explanation offered by assessee about the nature and source thereof is, in

the opinion of the Assessing Officer, not satisfactory. Sumati Dayal Vs. CIT (SC) 214 ITR 801.

Assessee has to establish identity of subscribers to share capital and prove their creditworthiness and genuineness of transaction; Furnishing of Income Tax file numbers may not be sufficient to discharge the burden – CIT V. Nivedan Vaniya Niyojan Ltd. (2003) 130 Taxmann 153/263 ITR 623 (Cal.)

Let me refer to now provisions of section 68 of the Act (upto A.Y. 2012-13)

Section 68 of the act provides that if any sum is found credited in the books of any assessee and he either :

- Does not offer any explanation about nature and source of money; or
- Explanation offered by him is not to the satisfaction of Assessing Officer ,
- Then, such amount can be taxed as his income.

The primary onus of satisfactory explanation of such credits is on assessee.

It is important to note the recent decision of Hon'ble high court of Delhi in case of CIT vs. Nova Promoters & Finlease (P)Ltd. [(2012)18 taxmann 217] wherein Hon'ble Justice Mr. R. V. Easwar held that "there is ample authority for the position that where an assessee fails to prove satisfactorily the source and nature of certain amount of cash received during the accounting year, the income tax officer is entitled to draw the inference that the receipt are of an assessable nature. Section 68 recognizes the aforesaid legal position. The view taken by the Tribunal on the duty cast on the assessing officer by section 68 is contrary to the law laid down by the Supreme Court in the judgment cited above.

ITAT Delhi Bench in the case of Janki Jewellers vs. ITO Ward-4 held as under:

"The Assessing Officer should also allow an opportunity to the assessee to establish the identity and creditworthiness of the share applicants and also



to establish the genuineness of the transactions in question and after considering all these aspects and after providing adequate opportunity of being heard to the assessee, the Assessing Officer should pass necessary order as per law.

Further ITAT Delhi Bench in the case of ITO Ward-5 vs. M/s Kushara Real Estate (P)Ltd, it was held that whether the transaction in question is genuine transaction or not should be decided and for the purpose the matter was remanded to CIT(A) for passing a specking order regarding receipt of share capital with high premium.

**View in favour of the proposition:**

Let me refer to the landmark judgments in favour of the proposition:

**CIT v. Lovely Exports (P)Ltd (2008)216 CTR 195 (SC):**

The onus cast upon the assessee company was discharged upon disclosure of the names and particulars of the alleged bogus shareholders. It was for the department to conduct its own enquiry thereafter and addition if any may be in the hands of the shareholders.

**CIT v. Steller Investment Ltd.(2001) 115 Taxman 99 (SC):**

Even if subscribers to the capital are not genuine, the amount received by the company as share capital could not be assessed in the hands of the company itself. Such amounts should be considered for assessment in the hands of persons who are alleged to have really advanced the money.

**CIT v. Divine Leasing & Finance Ltd. (2007) 158 Taxman 440(Delhi)- Delhi High Court**

The judgment held that the amount of share application money received by a company from alleged bogus share holders could not be regarded as undisclosed income u/s 68 when the assessee furnished details regarding shareholders. If the names of the alleged bogus shareholders are given to the AO, then the department is free to proceed to reopen their individual assessments in accordance with law. The Supreme Court upheld this view.

**CIT v. STL Extrusion (P) Ltd. (2011) 333 ITR 269/11 taxman.com 125(MP):**

Where assessee had duly discharged its onus by furnishing names, age, address, date of filing application of share, number of shares of each subscriber, the AO was not justified in making addition u/s 68.

**CIT v. Arunananda textiles (P)Ltd. (2011) 203 taxman 32 (Mag.)/15 taxman.com 226(kar.):**

It was not for the assessee to pace material before the Assessing officer about creditworthiness of the shareholders. Once the company had given the addresses of the shareholders and their identity was not in dispute, it was for the assessing officer to make further inquiry with the investors about their capacity to invest the amount in shares.

**CIT v. Dwarkadhish Investment (P)Ltd. (2010) 194 Taxman 43/ (2011) 330ITR 298 (Delhi):**

Once the assessee proves the identity of creditors/ share applicants, by either furnishing their PAN or income tax assessment numbers, and shows genuineness of transaction by showing money in his books either by account payee cheque or draft or by any other mode, onus of proof would shift to revenue.

**CIT v. Creative World Telefilms Ltd. (2011) 203 taxman 36/333 ITR 100/15 taxman.com 183 (Bom.)**

Once documents like PAN card, bank account details or details from the bankers were given by the assessee, onus shifts upon the Assessing Officer and it is on him to reach the shareholders. The Assessing Officer could not burden the assessee merely on the ground that summons issued to the investors were returned back with the endorsement not traceable

The decisions were based on a settled legal position, application to any cash credit like loans, deposits, advances, share capital or others, that;

- Primary onus is on assessee;
- An assessee does not have to establish source of source;
- If primary onus is discharged, burden shifts to Tax department;
- AO needs to discharge his burden and reach an objective satisfaction;
- AO has a discretion to assess cash credits;

- In a given case the amount can be assessed in the hands of investor/lender under other applicable provisions of law, like section 69.

**Summation:**

The Law on section 68 regarding share applications and share capital money received by the company upto A.Y. 2012-13, is as good as settled in view of the decision of Supreme Court in lovely exports Pvt. Ltd. 216 CTR 195. Their lordships of Supreme court held as under:

“Whether share application money can be treated as undisclosed income of the assessee? If the share application money is received from alleged bogus shareholders, whose names are given to AO, then department is free to proceed to reopen their individual asst. in accordance with law, but it cannot be regarded as undisclosed income of the assessee.”

The special leave petition against the judgment of lovely exports was dismissed by their lordships of Supreme Court reported in 319 ITR 5. The question is whether special Leave petition dismissal by speaking order in lovely exports attracts binding force of article 141. The answer appears to be yes. The reference is invited in the judgment of Supreme Court in the case of Kunhayammed and Others vs. State Of Kerala And Another, Reported in 245 ITR 360. Another issue which is not yet tested is whether the decision of Lovely Exports can be applied in the context of unsecured loan taken by a corporate assessee. Answer appears to be yes, i.e. when unsecured loan is taken by a corporate assessee and identity of the borrower is established the department is free to proceed to tax the individual borrower in accordance with law but it cannot be regarded as undisclosed income of the assessee.

This settled law has been unsettled by the amendment in Finance Act 2012 which has inserted to provisos to section 68 with effect from 01.04.2013 i.e. A.Y. 13-14.

The first proviso of this enlarges the onus of a closely held company and provides that if a closely held company receives any share application money or share capital or share premium or the like. it should also establish the source of source (that is, the resident from whom such money is received).

Second Proviso provides that the first proviso will not apply if the receipt of sum (representing share application money or share capital or share premium etc.) is from a VCC or VCF [referred in section 10(23FB)].

The objective of the amendment is to nullify the judgment of Supreme Court in the case of lovely exports 216 CTR.

It can be seen that First proviso is limited to the fiction providing for the circumstances in which the explanation given by the company in respect of the credits to share capital account, etc. would be deemed to be not satisfactory. In other words, it extends to the explanation required in the normal circumstances for any cash credit and in that, as discussed above, shifts the burden or imposes an additional requirement in cases of credit to share capital etc. to explain also the source of source (required for credit to share capital etc.)

In respect of the cash credit, the main provisions of section 68 would continue to apply, along with the additional requirement of the proviso.

The deeming consequences is mandatory and once the closely held company does not offer an explanation, the Assessing Officer has no discretion but to deem the sum as income as per the main provision. However, where a closely held company furnishes the explanation, which may be construed as unsatisfactory, it can be said that the Assessing Officer has a discretion and it is not mandatory for the Assessing Officer to make an addition [refer CIT v. Smt. P.K. Noorjahan [1999] 103 taxman 382/ 237 ITR 570(SC)].

Thus the law is clear and settled upto A.Y. 2012-13 to the effect that share application and share capital money cannot be taxed in the hands of the company and addition if any can be made only in the hands of shareholders. However from A.Y. 2013-14, the decision of lovely exports stands overruled and in case of closely held company the amended provision will apply and explanation is required about the nature and source of the cash credit in the hands of the residential holder. Thus the company is required to explain “Source of the Source”. This shifts the burden under section 68 and overrides the earlier position.

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