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C.V.O.CA'S
NEWS & VIEWS

From President's Desk...

Dear Professional Colleagues and Readers,

India is on the path to a sustained economic recovery, thanks to the vigorous countrywide drive to deliver safe and wide-reaching COVID-19 vaccinations, which helped reduce the severity of the third pandemic wave with minimal disruptions to mobility and economic activity.

Not withstanding the upside geopolitical risks and continuing fear of corona virus still haunting some parts of the globe, the domestic economy is set to be on a better footing with some early signs of revival. The GST collections during 2021-22 worked out to Rs. 14.83 trillion breaching its collection record of Rs.1.1 trillion per month since July 2021. The significance is the record collections of Rs.1.40 trillion in March 2022 reflecting intensified economic activities. The net direct tax collections reached an all-time high of Rs.13.81 trillion in financial year 2021-22 against Rs. 9.45 trillion collections in FY 2021-22.

The overall buoyancy is resonating in stock markets too with BSE sensex at 59277 on April 1 and is well set to reach the psychological level of 60000 mark while NSE at 17670 is emitting positive signals. Both indices gained more than 3 percent during the week despite the gyrations in global stock markets. LIC, largest Insurance Company in India, which has a valuation of Rs. 6 lakh crore, is raising Rs. 21,000 crore through its public offer.

Risks to the outlook include uncertain global economic conditions, potential new surges in COVID-19 cases, and sharp rises in commodity prices. Inflation will likely increase to 5.8% in FY 2022 amid rising oil prices.

Despite the ongoing global unrest, the domestic economy is able to maintain its tempo of growth due to appropriate fiscal and monetary policy backed with the implementation rigor to speed up the revival of the economy. If the war ends soon, India will emerge much stronger during FY23 going beyond the expected growth trajectory.

Events in Retrospect

- Capital Market Committee had planned 2nd Industrial Visit to **Filatex Limited** at Dahej. More than 40 participants took benefit of the Visit. It was great learning experience for members.

Upcoming Program

- Program Committee has planned & organised **Public Program on Alternate Investment Plans** on 7th May, 2022 at Yogi Sabhagruh. I request all members to attend the programme and also encourage to non-members to attend the same and get maximum benefit of it.
- **Students RRC**

  The power of youth is the common wealth for the entire world. The faces of young people are the faces of our past, our present and our future. No segment in the society can match with the power, idealism, enthusiasm and courage of the young people. **Student RRC** is planned on 2nd & 3rd June, 2022 at **Tithal, Valsad**. All CVOCA firms are requested to register their article Students to make part of learning & networking experience.
- With increasing complexities in GST Law, Publication & Training Committee has planned 2nd **GST Course**, in which more than 70 participants are enrolled for training with experienced GST Professional Members.

Stay healthy, Stay safe.

Thank you all..... Always in Gratitude

May 1, 2022

CA Rahul Nagda

304, Jasmine Apartment, Dada Saheb Phalke Road, Dadar (East), Mumbai - 400 014. Tel.: 2410 5987 | E-mail : info@cvoca.org | Website : www.cvoca.org
Follow us on : @cvocain @CVOCA Association @cvoca YouTube http://bit.ly/cvocayt


Income from
Unexplained
Sources

!!! ROLE OF SADGURU IN ELEVATION OF SPIRITUAL JOURNEY!!!

CA Dinesh Shah
Email : swastikdns@hotmail.com

FROM THE DESK OF CHAIRMAN

In previous occasion, in the month of March and April 2022 issues, we had discussed Diksha and Diksha Isn't About what you Give Up, In this issue we will make an attempt to discuss the Role of Guru in elevating our spiritual Journey, The realized Masters have elucidated many paths leading to the upliftment of the Soul.

Without the blessing and Guidance, It would be very difficult or Impossible to elevate oneself in spiritual Journey, Guru is not a physical form. Guru is energy, the medium through which jnana or knowledge flows to the shishya or disciple. If we take the shishya to be an ice-cold stone and jnana to be boiling hot water, then the guru pours this hot water onto the cold stone gradually, drop by drop, Guru takes full responsibility of the shishya, monitors him every second. Guru literally carries the journey of evolution. He is not someone who does sweet talk or makes arbitrary promises to gain your support… A guru needs nothing from you, it is you who needs him. He is the mirror that will show you, your true self and helps you elevate yourself, provided you want to rise.

The first sign of a guru is vairagya or detachment. As soon as you come in the proximity of your guru, you experience the same vairagya within-an indication that you are in the right place. He possesses phenomenal energy, makes us realize the SELF

The Guru is a vast ocean of Consciousness. In his gracious presence, body consciousness is naturally relegated into the background and soul awareness manifests: the world is forgotten and truth easily recollected. The one whose eyes shower benevolence, whose words are mantras and at whose Lotus Feet lies the essence of all the holy pilgrimages- such is a Guru.

The relationship between a teacher and student is mainly intellectual, not emotional: so their relationship is not very personal. To impart knowledge, exchanging words is all that is necessary, however, the relationship between a Guru and disciple is very personal: it reaches the depths of the heart and soul. One needs to experience this relationship of divine love !

Once we accept a Sadguru's refuge, there is no turning back. Now, there is neither peace in your life, nor the option of turning back or quitting. On one hand, there is restlessness and disgruntlement because the Sadguru will not change his ways to suit you. On the other hand, there is no escaping from his intense love. The Sadguru does not rest either, using ingenious methods, he creates tunnels through the mountains of one's ego to let out the springs of purity

The Sadguru's compassion is so extraordinary that if he needs to be harsh with us and to train us, he will not think twice, though his heart is as tender as a flower. He will not hesitate to don his armour and strike like lightning for our welfare, though he would not lay a finger on another life, that will not prevent him from hurling a hammer to break the disciple's ego. Consider yourself very fortunate if you ever meet such a Guru., A true disciple finds great joy in living in accordance with the guru's commands. If we go to the Guru with a clear purpose, there is no sense of servitude or fear. But where there is lack of love, faith and surrender or if our purpose is unclear, then the Guru is perceived as an ordinary person and there is scope for contrary feelings like fear and bondage to arise.

The person who seeks the Guru's presence to fulfill a higher purpose of liberating himself from various faults, including his ego, values the advantages gained by obeying the Guru's commands and carries them out joyfully. Although he is aware of his several shortcomings, he can also see ways in which they can be diminished and overcome, and this feuds his enthusiasm. When the interest is genuine, one does not feel fatigued. When one understands the benefit to be accrued, he does not feel bondage. Where there is love, there can be no fear, Sincere love heralds fearlessness,. Where love is lacking, there is fear, and where there is fear, there are feelings of subjugation, bondage and suffering. Total surrender, give everything that is yours, surrender yourself. While still alive, die at the feet of the Guru.

!!! TREAT OTHERS THE WAY YOU WANT TO BE TREATED !!!

!!! REMEMBER !!! "THE SOUL IS ON JOURNEY"

Thank you all..... Always in Gratitude

CA Dinesh Shah

CASH CREDIT – FUNDAMENTAL PRINCIPLES

CA Avani Gada
Email : avani.gada@gmail.com

Background

Generation of black money and its stashing abroad in tax havens and offshore financial centers have dominated discussions and debate in public foram during the past several years. Members of Parliament, the Supreme Court of India and the public at large have unequivocally expressed concern on the issue, particularly after some reports suggested estimates of such unaccounted wealth being held abroad.

There are several measures taken at an International level over the years to combat the menace of generation of black money and its round tripping. Some of the measures taken at an international level includes Establishment of Financial Action Task Force on money laundering ("FATF") in 1989, Establishment of Eurasian Group on Combating Money Laundering at an International level and Financing of Terrorism in 2004.

The international consensus on the need for coordinated action in the fight against the menace of black money requires parallel action at country level. Accordingly, a number of proactive steps have been taken by GOI in order to create an appropriate legislative framework for preventing the generation of black money and for its detection, in addition to Introduction of Prevention of Money Laundering Act, 2002 ("PMLA"), Entering into Tax Information Exchange Agreement ("TIEA")and Demonetization.

Section 68 –An anti-abuse provision to curb black money and its round tripping

Section 68 of the Income-tax Act, 1961 ("the Act") is one such anti-abuse provision introduced for the first time by Finance Act, 1961 in the Income-tax Act, 1961 ("the Act") w.e.f. 1 April 1962, which had no corresponding provision in the erstwhile Act, i.e. Income-tax Act, 1922. However, cash credit has been a subject matter of tax litigation in India much before the introduction of section 68.

Objective of section 68

As mentioned above, the intention behind introduction of section 68 was to investigate and prevent any sort of money laundering and conversion of black money and to prevent generation and circulation of unaccounted money and clamp the prevailing practices like (a) Concealment of unaccounted cash by showing the same as lent or deposited with them by third parties; (b) Showing of unaccounted cash as their own capital contribution; (c) Showing the alleged loan as repaid and other illegal practices.

Conditions for applicability of section 68

The existing provisions of the aforesaid section 68 provides that *"where any sum is found credited in the **books of an assessee** maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the assessing officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year….."*

Therefore, section 68 can be enforceable only when following conditions are satisfied:

a) The assessee maintains books of accounts; and

b) Credit entry occurs in such books; and

c) No explanation or absence of satisfactory explanation by the assessee about the nature and source of such credit;

Each condition is explained in detail below:

a) The assessee maintains books of accounts:

- The word "Books" is defined under the Section 2(12) of the Act. The existence of the books is the foremost condition for applicability of section 68.
- The expression "books of the assessee" appearing in section 68 refers to the assessee whose books show the credit entry. A perusal of this section would show that in relation to the expression "books", the emphasis is on the word "assessee" meaning thereby that such books have to be the books of the assessee himself and not of any other assessee[1].
- In the assessment of a partner, the mere fact that the cash credit entries had been found in the books of the firm of which he was a partner was held immaterial, because the books in which such entries had been found were those of a different assessee[2].
- The passbook of the bank is not regarded as a valid account books under the section 68[3].
- Rough books are also books[4].
- Loose sheets are not books. Where loose sheets are found, there is usual inference of the AO that they represent concealed transaction. Such inference does not readily follow. It can be positively made only after identification of papers and after due verification[5].

b) <u>Credit entry occurs in such books:</u>

- Section 68 may cover credits other than cash. Credits under section 68 has to be understood to include all amounts met for payments found in assessee's books and not merely for cash receipts as loans.
- The section does not make any distinction between commercial loans[6] and non-commercial loans or between amounts credited to an account of a third party and those credited to the assessee's own capital account[7].
- The language of section 68 shows that it is general in nature and applies to all credit entries in whomsoever name they may stand, i.e., whether in the name of assessee or a third party[8].
- ***<u>Not confined to cash credits</u>*** – Though section 68 deals with cash credits, it is not confined to credits in cash. Other credits by way of liabilities also requires explanation as stipulated under section 68, so that when they are not satisfactorily explained, they are bound to be added[9].

[1]Shanta Devi v CIT (1988) 171 ITR 532 (P&H)
[2]Sunder Lal Jain v CIT (1979) 117 ITR 316 (All)
[3]CIT v Bhaichand H Gandhi (1983) 141 ITR 67 (Bom)
[4]Haji Nazir Hussain v ITO (2004) 271 ITR (AT) 14 (Del.)
[5]Goyal (S.P.) v DCIT (2004) 269 ITR (AT) 59 (Mum)
[6]Kant & Co (C) v CIT (1980) 126 ITR 63 (Cal)
[7]Dharmavat Provision Stores v CIT (1983) 139 ITR 700 (Bom)
[8]Gumani Ram Siri Ram v. CIT [1975] 98 ITR 337 (Punjab & Haryana High Court)
[9]V I S P (P) Ltd v CIT (2004) 265 ITR 202 (MP)

c) **No explanation or absence of satisfactory explanation by the assessee about the nature and source of such credit:**

- **Burden of proof**: Section 68 places the burden of proof on the taxpayer to explain the nature and the source of any credit found in the books. Once the assessee produces evidences about identity and creditworthiness of the lender and genuineness of transaction, the burden of proof shifts to the revenue[10].

- **Expression "assessee offers no explanation"**: The expression "assessee offers no explanation" means where the assessee offers no proper, reasonable and acceptable explanation as regards the sum found credited in the books maintained by the assessee. The opinion of the AO for not accepting the explanation offered by the assessee as not satisfactory is required to be based on proper appreciation of material & other attending circumstances available on record. The opinion of the AO is required to be formed objectively with reference to the material available on record. Application of mind is the sine qua non for forming the opinion[11].

- **No burden on the tax officer to locate the exact source**: Where the assessee has failed to prove satisfactorily the source and nature of the credit entry in his books and it is held that the relevant amount is the income of the assessee, it is not necessary for the department to locate the exact source[12]. No further burden lies on the revenue to show that the income is from any particular source[13].

- **Contrary evidence provided by tax officer**: If the explanation offered by the assessee about the nature and source of credit is not satisfactory in the opinion of the AO and produces some prima facie evidence against the explanation of the assessee or not matching with the explanation given by the assessee the assessee has to rebut the same. If assessee fails to do so, the said evidence being unrebutted can be used against him by holding that it is a receipt of income in nature[14].

- **Prerequisites to satisfy the AO**: The prerequisites to satisfy the Assessing Officer as explained by Delhi High Court in case of CIT v. Lovely Exports Pvt Ltd (2008) 299 ITR 268 (Delhi) are as under:

  "In the case of a company the following are the propositions of law under section 68. The assessee has to prima facie prove:

1) *the identity of the creditor/subscriber;*

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

3) *the creditworthiness or financial strength of the creditor/subscriber;*

4) *if relevant details of the address of PAN identity the creditor/subscriber 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;*

5) *the Department would not be justified in drawing an adverse inference only because the creditor/subscriber fails or neglect to respond to its notice;*

6) *The Assessing Officer is duty bound to investigate into the credit worthiness of the creditor/subscriber, the genuineness of the transaction and the veracity of the repudiation."*

[10] ITO v. Anant Shelters (P.) Ltd. [2012] 20 taxmann.com 153/51 SOT 234 (Mum.)
[11] CIT v. P. Mohanakala [2007] 291 ITR 278 / 161 Taxman 169 (SC)
[12] CIT v. M. Ganapathi Mudaliar [1964] 53 ITR 623 (SC)
[13] Roshan Di Hatti v. CIT [1977] 107 ITR 938 (SC)
[14] Sumati Dayal v. CIT [1995] 80 Taxman 89/214 ITR 801 (SC)

The Hon'ble Delhi High Court in CIT v. Oasis Hospitalities Pvt. Ltd.[2011] 9taxmann.com 179/198 Taxman 247/333 ITR 119 (Delhi), held that:

"The initial onus is upon the assessee to establish three things necessary to obviate the mischief of Section 68. Those are:

i. identity of the investors;

ii. their creditworthiness/investments; and

iii. genuineness of the transaction

The departments exercise starts only when these three ingredients are established prima facie, by the assessee and the department is required to investigate into the facts presented by the assessee."

- Assessee not bound to prove source of the source: Once the assessee is able to establish that he has in fact received money from a third party, he cannot be burdened with a further onus of establishing the source from which such third party had been able to obtain the moneys[15].

- **Genuineness of transaction in case of gifts**: The inference of genuineness of gifts does not readily follow merely on identification of the donor or on receipt of money through banking channels. His capacity to make a gift is equally relevant. In fact, the credibility of such gifts, except where it is proved beyond doubt, would appear to be relevant as held by Supreme court[16].

Special provision for closely held company - Share application money

- Certain judicial pronouncements have discussed on the scope of onus of proof and the requirements of section 68 in cases where the sum is credited as share capital, share premium, etc.

- For instance, in the case of *CIT* v. *Lovely Exports (P.) Ltd.* [2008] 216 CTR 195, the Supreme Court held that if share application money was received by the assessee-company from alleged bogus shareholders, whose names were given to the Assessing Officer, then the Department was free to proceed to reopen their individual assessments in accordance with the law but this amount of share money could not be regarded as undisclosed income under section 68 of the assessee-company. Similar rulings are given in cases of CIT v. Steller Investment Ltd. [2001] 115 Taxman 99 (SC), *CIT* v. *Kamdhenu Steel & Alloys Ltd.* [2012] 206 Taxman 254.Thus, the courts have held that assessee is not required to prove source of source of the creditor.

- In order to overcome these decisions, at least in those cases where share application money is received through private placements, an additional onus, needed to be placed to prove the source of money in the hands of such shareholder or persons making payment towards issue of shares before such sum is accepted as genuine credit, the provision of section 68 was amended by Finance Act, 2012 and two provisos were added which strengthened the burden on closely held companies to establish the source of the funds received by it while exempting money received from venture capital funds and venture capital company from the ambit of the provision.

- The Memorandum to the Finance Bill, 2012 explained the need for the addition of these 2 provisos to Section 68 of the Act as below:

[15]CIT vs Daulat Ram Rawatmull (1973) 87 ITR 349 (SC)
[16]CIT vs Mohanakala (P) (2007) 291 ITR 278 (SC)

"In the case of closely held companies, investments are made by known persons. Therefore, a higher onus is required to be placed on such companies besides the general onus to establish identity and creditworthiness of creditor and genuineness of transaction. This additional onus needs to be placed on such companies to also prove the source of money in the hands of such shareholder or persons making payment towards issue of shares before such sum is accepted as genuine credit. If the company fails to discharge the additional onus, the sum shall be treated as income of the company and added to its income."

- The Proviso to section 68 inserted by the Finance Act, 2012 w.e.f. 1 April 2013 reads as under-

  "*Provided that where the assessee is a company (not being a company in which the public are substantially interested), and the sum so credited consists of share application money, share capital, share premium or any such amount by whatever name called, any explanation offered by such assessee-company shall be deemed to be not satisfactory, unless —*

  a) the person, being a resident in whose name such credit is recorded in the books of such company also offers an explanation about the nature and source of such sum so credited; and

  b) such explanation in the opinion of the Assessing Officer aforesaid has been found to be satisfactory:

  Provided further that nothing contained in the first proviso shall apply if the person, in whose name the sum referred to therein is recorded, is a venture capital fund or a venture capital company as referred to in clause (23FB) of section 10."

- A reading of the above Proviso indicates that it will be applicable to-
  - A closely held company, i.e. a company in which public are not substantially interested and receiving in its books the credit from a resident.
  - The sum so credited should be of the nature of share application money, share capital, share premium or any such amount by whatever name called.
  - Explanation about the nature and source of the credit would not be deemed to be satisfactory, unless-
    - Person in whose name such credit is recorded offers an explanation about the nature and the source of such credit; and
    - Explanation by such person is to the satisfaction of AO
  - Where the creditor is not able to satisfactorily explain nature and source of the credit in the books of the assessee, then such sum shall be treated as income of the assessee.
  - The above Proviso will not be applicable in following cases:
    - Credits in the books of a company, which is not closely held company.
    - If the person in whose name the sum is credited is a venture capital fund or a venture capital company, as referred to in section 10(23FB) of the Act.
    - Credits in the books of closely held companies in the name of non-residents.
    - Credits in the books of closely held companies where credits are not in the nature of share application money or share capital or share premium.

Amendment by Finance Act 2022

- The additional burden on the assessee u/s 68 to prove source of source is quite specific and is applicable only in case of closely held companies and that to in case of sum received in the form of share application money or share capital from non-resident. Prior to A.Y. 2023-24, there was no such similar additional burden in case of sum received in the form of loan or borrowing.

- As per the memorandum to Finance Bill, 2022, it was noticed that there was a pernicious practice of conversion of unaccounted money by crediting it to the books of assesses through a masquerade of loan or borrowing.

- In view of the above, Finance Act 2022 has inserted additional proviso to section 68 to provide that the additional burden of proving source of source will also be applicable in case of loan or borrowing received by a taxpayer from any person (resident or non-resident), while exempting money received as loan or borrowing from venture capital funds and venture capital company from the ambit of the provision.

- The additional proviso to section 68 as inserted by Finance Act, 2022 reads as under:

  "Provided that where the sum so credited consists of loan or borrowing or any such amount, by whatever name called, any explanation offered by such assessee shall be deemed to be not satisfactory, unless, —

  a) the person in whose name such credit is recorded in the books of such assessee also offers an explanation about the nature and source of such sum so credited; and

  b) such explanation in the opinion of the Assessing Officer aforesaid has been found to be satisfactory"

- The conditions for applicability of the aforesaid proviso are as under:
  - Sum credited should be by way of loan or borrowing or any such amount by whatever name called;
  - Sum may be credited in the books of any taxpayer, whether or not a company and in case of company, whether or not a closely held company;
  - Credit can be in the name of any person, whether or not a resident;
  - Explanation about the nature and source of the credit would not be deemed to be satisfactory, unless-
    - Person in whose name such credit is recorded offers an explanation about the nature and the source of such credit; and
    - Explanation by such person is to the satisfaction of AO
  - The above Proviso will not be applicable If the person in whose name the sum is credited is a venture capital fund or a venture capital company, as referred to in section 10(23FB) of the Act.

Practical issues in applying the new proviso:

✓ It is to be noted that the Finance Act 2022 has provided exemption from the ambit of the applicability of section 68, to the money received from Venture Capital company and Venture capital fund only.

- ✓ There is no similar exemption provided to the money received in the form of loan or borrowing from any banking company or any financial institution or a Government Company or a corporation established by a Central, State or bank or Provincial Act; in line with the exemption provided under section 269SS, 269ST and 269T.

- ✓ In the absence of any such exemption, it would become difficult to comply with the aforesaid section practically. For instance, in case of a loan taken from a bank by an assessee, it would be difficult to explain/prove the nature and source of money received by such lender bank.

Taxability of income determined - Section 115BBE

- As per white paper on "Black money" issued by Ministry of Finance, Department of Revenue, CBDT in May 2012, "A number of other significant changes have been proposed in the Income Tax Act through the Finance Bill 2012 which includes - To create greater deterrence against black money, unexplained amounts deemed as income of a taxpayer under sections 68, 69, 69A, 69B, 69C and 69D of the Income Tax Act 1961 are proposed to be taxed at the maximum marginal rate without any allowance or deduction."

- As per section 115BBE, if the total income of the assessee includes any income referred to in section 68 of the Act, then tax on such income shall be calculated at the tax rate of 60%. Surcharge @25% and Cess @4% shall be levied separately.

- No deduction in respect of any expenditure or allowance or set-off of any loss shall be allowed to the assessee in computing the income u/s 68 of the Act.

Conclusion

Financial crimes, including tax crimes, money laundering, and terrorist financing, undermine jurisdictions' political and economic interests and pose a serious threat to national security. By their very nature, tax crimes are closely linked to other financial crimes and it is well recognized that tax authorities have a central role to play in identifying and reporting money laundering.

Hence, it is very essential to have stringent provisions in order to protect the economy of the country. Though section 68 of the Income Tax Act, 1961 does well in this regard and there is a clear message from Government to combat the practice of generation of black money, there are practical challenges relating to amendment made by Finance Act 2022 to prove source of source in case of loan or borrowing from financial institution. Some relaxation in this regard from CBDT will be a need of an hour!!

BENEFIT OF TELESCOPING

CA Haresh Kenia
Email : hpkenia@gbca.com

'Telescoping', is a word extensively used under the Income Tax Law and its theory is widely applied across the taxability of a wide range of items, usually the items of income which are covered by sections 68 to 69D of the Income-tax Act. However, no specific definition has been accorded to the term 'telescoping' either under the Act or even the Judicial Law. In simple words, in case where an assessee has certain undisclosed income and also certain undisclosed investments, then it could be reasonably presumed that the undisclosed investments have been sourced out of the undisclosed income, so that only the income may be taxed or only the investment may be taxed and not both, in the hands of the assessee under the provisions of the Act. The term 'Telescoping' or 'theory of telescoping 'would mean as identifying an income and its application, so that ultimately tax is levied either only on the income or only on its application. The basic principle behind the theory is that there should not be overlapping additions and only the actual and real income of the assessee is taxed. The theory is applied keeping in view the well-established canon of taxation that the same income cannot be taxed twice – once on earning and then on utilizing / expending it. The said theory is generally applied in cases where block or search assessments are framed.

As in case of large number of non-genuine credit and debit entries, peak theory may be applied, similarly, additions for low gross profits can be given credit against unapproved cash credits or unexplained expenditure or investment with similar set offs between additions and such practice is known as telescoping.

For example, there may be a case where there is an unexplained income of an assessee in the first part of a year and also a corresponding unexplained investment of somewhat similar amount in the later part of the year, in such case unless there is evidence to the contrary, it may be treated that the unexplained investment has been made out of the unexplained income. Thus, in such case instead of adding both unexplained income as well as unexplained investment to the income of the assessee, it would be wise to add one of them, as both represent only one income. This is called telescoping. The said theory is judicially accepted or got recognition in *Anantharam Veerasinghaiah & Co. v CIT (1980) 123 ITR 457 (SC.).*This theory is judicially accepted is in effect, a theory of probability or inference which is applied in order to avoid taxing the same income twice – once on earning and then on utilizing / expending it. Ref. CIT vs. S. Nelliappan – (1967) 66 ITR 722 (SC).

In the case of *CIT v. Sharraf Trading ,376 ITR 534 (All)* , it was held that even peak credit taxed in the earlier year is available for telescoping against peak credit worked out in the subsequent year and therefore not taxable. In the context of telescoping following observations of *Kantilal & Bros v. ACIT (1995) 52 ITD 412 (Pune)* are worth noting -

"It would be contrary to the canons of law to tax the same amount twice, i.e., as borrowings and as cost of assets. The borrowings were utilised to acquire the assets. Once the contention of the assessee, that the amount as reflected in the 'seized paper' represented borrowings of the assessee, was accepted, it would be proper to presume that such amount was utilised for the acquisition of assets found at the time of search."

In the case *CIT v. S. Nelliappan 66 ITR 722* , the Hon'ble Supreme Court held that even in the absence of direct evidence of any connection between the cash credit entries and the income withheld from the books of account by the assessees if the Tribunal inferred that there was a connection between the profits withheld from the books and the cash credit entries, then the said conclusion must be upheld and it cannot be said that the conclusion is based upon speculation

The following are the certain well accepted, fundamental principles of taxation on which the entire theory of telescoping rests.

- ***The same income cannot be taxed twice in the hands of the same person*** as held by supreme court in case of ITO v. Bachual Kapoor 60 ITR 74 and in case of Laxmipat Singhania v .CIT 71 ITR 291. The Supreme court in the case of Mahavir Kumar Jain ,92 taxmann.com 340 has categorically held *that "It is a fundamental rule of law of taxation that, unless otherwise expressly provided, income cannot be taxed twice. A taxing Statute should not be interpreted in such a manner that its effect will be to cast a burden twice over for the payment of tax on the taxpayer unless the language of the Statute is so compelling that the court has no alternative than to accept it. In a case of reasonable doubt, the construction most beneficial to the taxpayer is to be adopted*

  In this case issue was as under

  The assessee had paid income tax at source on winning from lotteries in State of Sikkim as per Sikkim State Income Tax Rules, 1948 applicable at relevant time in Sikkim. The revenue treated the lottery amount as taxable under the provisions of Income Tax Act. The court interpreted Section 5 of Income Tax Act would not be applicable and the existing Sikkim State Income Tax Rules, 1948 would be applicable. Once Sikkim State Income Tax Rules, 1948 are applied on the same Income, two types of income taxes cannot be applied. It was examined whether in fact there is a specific provision for including the income earned from the Sikkim lottery ticket prior to 01.04.1990 and after 1975, in the income-tax return or not. It was found that no specific provision has been made by the legislature for including such an income by an assessee from lottery ticket. Accordingly, in the absence of any such provision, the assessee in the present case cannot be subjected to double taxation. It was deliberated and held that

  "It is not disputed that there can be double taxation if the legislature has distinctly enacted it. It is only when there are general words of taxation and they have to be interpreted, they cannot be so interpreted as to tax the subject twice over to the same tax….. If any double taxation is involved, the Legislature itself has, in express words, sanctioned it. It is not open to any one thereafter to invoke the general principles that the subject cannot be taxed twice over."

  Furthermore, a taxing Statute should not be interpreted in such a manner that its effect will be to cast a burden twice over for the payment of tax on the taxpayer unless the language of the Statute is so compelling that the court has no alternative than to accept it. In a case of reasonable doubt, the construction most beneficial to the taxpayer is to be adopted. So, it is clear enough that the income in the present case is taxable only under one law.

- ***<u>The income taxed in one year be not taxed in another year</u>*** as held by Calcutta high court in the case of CIT vs. Ramshankar – 45 Taxman 282

  In this case issue was as under

  The assessee is an individual carrying on business in the name of Binapani Engg. Works. He is also a partner in two firms, viz., Howrah Iron & Scrap Co. and Bhagwandas Ramasankar. The original assessment for the years 1955-56 and 1956-57 under appeal were completed at Rs. 21,635 and Rs. 30,311 respectively. In the course of the assessment proceedings for the assessment year 1957-58 the ITO found that there was substantial increase in the capital account of the assessee in the books of Howrah Iron & Scrap Co. The capital account of the assessee at the end of the accounting year relevant to the assessment year 1954-55 showed a balance of Rs. 21,938 and it was increased to Rs. 1,41,477 at the end of the accounting year relevant to the assessment year 1956-57. Accordingly, he issued necessary notice for reassessment to the assessee. The assessee filed returns under protest. During the reassessment proceedings, the ITO enquired of the assessee to explain the increase in the capital account in the books of Howrah Iron & Scrap Co. from Rs. 21,938 to Rs. 1,41,477. The ITO in this order dated 28-3-1968 made under section 144/147 of the Act observed that the capital introduction was made out of the assessee's own undisclosed income and accordingly treated a sum of Rs. 1,19,639 (Rs. 1,41,477 minus Rs. 21,938) as the assessee's income from other sources. For the assessment year 1956-57, in his order dated 26-3-1968 after observing that the position remained the same exactly as stated in detail in his assessment order for the assessment year 1955-56, the ITO once again treated Rs. 1,19,539 as the assessee's income from 'other sources'.

  it was not the case that the amount included in both the assessment years was not liable to tax at all. The question was in which year it should be assessed to tax. Accordingly, the Tribunal should have come to a finding as to whether the amount in question was assessable either for the assessment year 1955-56 or 1956-57. It was no doubt true that the same income could not be taxed twice. If the ITO did not decide the issue conclusively, it was for the Tribunal to re-order a decision on the issue or leave it to the ITO. Since, the assessments were set aside, the ITO was at liberty to decide the question afresh. The Tribunal was not right in deleting the addition solely on the ground that the same income was assessed in both the years.

- ***<u>The same cannot be taxed under two different heads</u>*** as held by Bombay high court in the case of CIT vs. Surat Cotton and Spinning – 202 ITR 932 (Bom.)

  The issue in this case dealt as under ;-

  There was no dispute that redemption of preferential shares amounted to transfer within the meaning of section 2(47) and that section 45 would apply to such transfers and the capital gain or loss would have to be computed. In the instant case, the assessee received a sum of Rs. 67,71,400 as consideration for the transfer. It was by virtue of the definition of 'dividend' contained in section 2(22) that whole of this amount was treated as dividend. That being so, the balance amount, if any, could only be held to be consideration for the transfer of preference shares for the purpose of computation of capital gains, which, in the instant case, was nil. The same receipt could not be treated by the ITO both as dividend and consideration received as a result of transfer of capital asset. The capital gain, therefore, had to be computed under section 48 by treating the consideration as nil and not Rs. 67,71,400 because doing so would amount to taking into account the same receipt twice - one for assessment as dividend income and again as consideration for computation of capital gain, which would amount to double taxation of the same receipt in the hands of the same person under two different heads, which was not permissible.

  Section 46 makes clear that in case where apart of the consideration had been assessed as dividend it was only the balance amount left with the assessee which could be said to be the consideration for the transfer and capital gains had to be computed under section 48 taking such balance amount only as the consideration for transfer.

The revenue very strongly contended that the extended definition of 'dividend' in section 2(22) is only intended for the purpose of bringing certain receipts to tax under the Act as dividend and this deeming provision cannot be carried further to reduce the amount of consideration for computation of capital gains. This was not correct. The law in this regard is well-settled. A deeming provision is intended to enlarge the meaning of a particular word which includes matters which otherwise may or may not fall within the provision. It should, therefore, be extended to the consequences and incidents which shall inevitably follow. In other words, the consequences and incidents flowing from a legal fiction should also be deemed to be real. In that view of the matter, the revenue itself having deemed the whole of the amount received by an assessee for relinquishment of its interest in a capital asset as dividend under section 2(22) for the purpose of assessment and levy of tax, it cannot be allowed to contend that this fact should not be taken into account in reducing the true amount of consideration for the transfer. The effect of deeming a part or whole of the consideration as dividend for the purpose of levy of income-tax was to reduce the consideration to that extent. There is no escape from this conclusion.

Further, the revenue's contention is that there is no bar in the Act on double taxation of the very same receipt under two different heads, viz., 'dividend' and 'capital gain'. This argument does not require any elaborate discussion whatsoever because it is well-settled that the very same income or the very same receipt cannot be assessed twice under two different heads of income. It should not be forgotten that what is chargeable to tax under the Act is the total income of the assessee. 'Dividend', which is income 'from other sources' and 'capital gains' are only two different heads under which the income falls to be charged. That being so, once a particular receipt has been treated as dividend, it cannot be treated as income under any other head. The duty of the ITO is only to find out the appropriate head under which the receipt in question can be assessed. Once the assessee receives a particular receipt under a particular head of income, that amount is no more available to him for assessment under another head.

Benefits of telescoping

There are various judgments of the Hon'ble Supreme Court and the various Hon'ble High Courts who have applied the theory of telescoping in dealing with income tax issues before them and applies ever since the income tax Act 1922 was in operation. This theory is practically applied in various situation for computing total income as under and are generally termed as 'Benefits of telescoping'

The following discussion merely summarises the various facets of the benefits of telescoping which are by no means exhaustive. However, I believe these would help the tax payer in taking an appropriate decision considering the utility of the theory of telescoping in determining the taxability of undisclosed income. Since the applicability of the theory of telescoping is vitally dependent on the fair and correct exercise of discretion by various authorities.

In this context, the words of the Hon'ble Chief Justice of India, Shri H. R. Khanna (as he then was) are worth noting , in the case of CIT vs. Simon Carves Ltd. CIT vs. Simon Carves Ltd. – (1976) 105 ITR 212 (SC) " *There is nothing before us to show that the discretion was not exercised by the said officer in a proper or judicious manner. It is also not suggested that the Income-tax Officer was actuated by some oblique motive. From the mere fact that the method selected by him was such as resulted in lower tax liability to the assessee compared to the liability which would have resulted from the adoption of other method, it would not follow that the discretion was not exercised in a proper and judicious manner. The taxing authorities exercise quasi-judicial powers and in doing so they must act in a fair and not a partisan manner. Although it is part of their duty to ensure that no tax which is legitimately due from an assessee should remain unrecovered, they must also at the same time not act in a manner as might indicate that scales are weighted against the assessee. We are wholly unable to subscribe to the view that unless those authorities exercise the power in a manner most beneficial to the revenue and consequently most adverse to the assessee, they should be deemed not to have exercised it in a proper and judicious manner."*

It is necessary to observe the following basic principles before applying the theory in any given situation on hand.

Onus of proving the source of a sum of money found ;- It is now well settled that the onus of proving the source of a sum of money found to have been credited by the assessee either in his name or in the names of third parties is on the assessee who must be held to have the special knowledge about the circumstances under which the credit was made by him or by his agent or clerks in the books of account maintained by him and if he fails to establish the source of such a cash credit satisfactorily, such amount can be treated by the taxing authorities as taxable income. It is for the assessee and not for the department, either to establish satisfactorily by independent evidence that the receipt was not income or that even if it was income, the same was not taxable as it was exempt or already taxed under a different head under the provisions of the Act. This important proposition is held by Kale Khan Mohammed Hanif v. CIT 50 ITR 1 (SC), govindarajulu mudaliar v. CIT 34 ITR 807 (SC), and CIT v. Devi Prasad Vishwanath Prasad 72 ITR 194 (SC).

It is to be noted that all these theories of telescoping are not a proposition of law and therefore the onus is on assessee to show some link between intangible additions and cash credits i.e., the credits represents / is covered from the intangible additions so made. In the case of Kale Khan Mohammed Hanif v. CIT 50 ITR 1, their Lordships of the Supreme Court have held that the onus of proving the source of a sum of money found to have been received by the assessee is on him and has further held that the amount of cash credit could be assessed to tax as income from undisclosed sources in addition to the business income computed by estimate. it was held that there is nothing in law which prevents the Assessing Officer in an appropriate case in taxing both the cash credit, the source and nature of which is not satisfactorily explained, and the business income estimated by him after rejecting the books of account of the assessee as unreliable. The taxing authorities were not precluded from treating the amount of credit entries as income from undisclosed sources simply because the entries appeared in the books of a business whose income, they had previously computed on a percentage basis. At this juncture , it is worth noting that in the case CIT v. K. N. Satyapalan 247 ITR 105 , the Kerala High Court rejected the theory of telescoping on the ground that there was no link between the intangible addition in the past assessment year and the cash credit in the current year

Assessee to prove that it is income from the source which has already been taxed;- whether the receipt is to be treated as income or not must depend very largely on the facts and circumstances of the case. Further, where an assessee fails to prove satisfactorily the source and nature of an amount credited in its accounts, the A.O. was entitled to draw an inference that the receipt is of an assessable nature.

In the case of *CIT v. Devi Prasad Viswanath Prasad, (1969) 72 ITR 194*, Supreme court held that ;-

"There is nothing in law which prevents the Income-tax Officer in an appropriate case in taxing both the cash credit, the source and nature of which is not satisfactorily explained and the business income estimated by him under Section 13 of the Income-tax Act, after rejecting the books of account of the assessee as unreliable………Whether in a given case the Income-tax Officer may tax the cash credit entered in the books of account of the business, and at the same time estimate the profit must, however, depend upon the facts of each case…… Where there is an unexplained cash credit, it is open to the Income-tax Officer to hold that it is income of the assessee and no further burden lies on the Income-tax Officer to show that that income is from any particular source. It is for the assessee to prove that even if the cash credit represents income, it is income from a source which has already been taxed."

- ***Unexplained investment and unexplained Expenditure are sourced out of the income already taxed as unexplained cash credits***

In cases where additions in respect of unexplained money/unexplained investment are sought to be made in the hands of the assessee. For example, if there is an addition in respect of undisclosed income or unexplained cash credits and also certain addition in respect of unexplained investments, then it can be pleaded by the assessee that the unexplained investment is sourced out of the income already taxed as unexplained cash credits as held in the case of CIT v. Jawanmal Gemaji Gandhi 15 Taxman 487 (Bom.)

In this case , the assessing officer made two additions to the income returned by the assessee, one on account of estimated turnover and gross profit rate and the other on account of the value of unexplained gold acquired by it during the relevant accounting period which had been eventually confiscated by the Central excise authorities. The Tribunal deleted the second addition on the ground that source of the amount used for acquiring gold could lie in the other intangible addition made during the year under appeal and similar additions made in the preceding years. The matter went to Supreme court . The court relying on judicial precedent in the case of Anantharam Veerasinghaiah & Co. v. CIT [1980] 123 ITR 457held that the secret profits or undisclosed income of an assessee earned in an earlier assessment year can constitute a fund, though concealed, from which the assessee may draw subsequently. The assessee, in the instant case, acquired the gold in the latter half of the assessment year: it could then very well be that the undisclosed income earned in that very year, which had been added on account of the increased estimated turnover, constituted the fund from which this asset was acquired. The conclusion reached in this behalf by the Tribunal was reasonable and justifiable.

It was held that the Tribunal was justified in deleting the addition of Rs. 9,375 as income from undisclosed source on the ground that there were other intangible additions made in the assessment for the preceding years as in the year under appeal. The Supreme Court has clearly stated that the secret profits or undisclosed income of an assessee earned in an earlier assessment year can constitute a fund, though concealed, from which the assessee may draw subsequently. That observation is clearly contrary to the finding of the Kerala High Court. The assessee acquired the gold during the latter half of the assessment year; it could then very well be that the undisclosed income of Rs. 10,702 earned in that very year constituted the fund from which this asset was acquired, accordingly having regard to all the circumstances that were before the Tribunal, that the source for the acquisition of the gold could well be assumed to be the addition of Rs. 10,702 to the assessee's income.

Similarly, it has been held that where an addition in respect of undisclosed income is made, the assessee could very well plead that there should be no separate addition in respect of unexplained expenditure from the said income since it would amount to double taxation as held by Bombay high court in case of CIT vs. Golani Brothers – (2018) 300 CTR 245.

- ***Concept of peak theory***

In those cases where there are a large number of unexplained credit and debit entries of a person/Bank account standing then in such case the AO may tend to add all the aggregate entries as unexplained income. However, in such case if the assessee does not have any explanation for every credit or debit entry of a person/Bank account standing in his books of account then one of the commonest defenses which an assessee may take is that, the entries should be so arranged in serial order, that a credit following a debit entry should be treated as referable to the latter to the extent possible and that, not the aggregate but only the `peak' of the credits should be treated as unexplained. Such an explanation is called as applying peak credit theory to the case of the assessee. It can be explained with the help of an example. Suppose there are credits in the assessee's books in the account of A of Rs. 5000 on 1st day of October, 2020 and again on 5th November, 2020 there is credit of Rs. 5000, but there is debit entry by way of repayment of Rs. 5000 shown on 27th October, 2020, the explanation will be that the credit appearing on 5th November, 2020 has or could have come out of withdrawal / repayment on 27th October, 2020. This plea is generally accepted as it is logical and acceptable (whether the creditor is a genuine or not), provided there is no material on record to show that a particular withdrawal/repayment has flown out of some other source or such withdrawal/repayment could not have been available on the date of the subsequent credit. When the same money is rotated in business, addition can only be made of peak amount. However, there should be both inflow and outflow of funds. If there is only inflow of funds, peak credit theory cannot be applied

The principle of peak credit proceeds on the fundamental premise that the money deposited and/or withdrawn from the assessee's account belongs to the assessee, or in respect of which ownership vests in the assessee. However, the peak credit theory may also be extended to the cases where the credits appear not in the same account but in the accounts of different persons. Even if the genuineness of all such persons is disbelieved and all the credits appearing in the different accounts are held to be assessee's own moneys, the assessee still will be entitled to a set off and a determination of the peak credit theory after arranging all the credits in chronological order. It is to be noted hereby that the above propositions cannot be treated as propositions of law. These are only the inferences which can be drawn based upon the normal probabilities. These inferences can also be displaced by any material on record which may indicate to the contrary. Thus, before taking the plea of peak credit theory before the assessing officer, it is necessary to understand the facts of the case. The basic principle behind the theory is that there should not be overlapping additions and only the actual and real income of the assessee is taxed.

The basic idea behind the peak credit theory is to avoid double addition and to bring only the actual income of the assessee to suffer tax, where there are large number of unexplained credit and debit entries. A bogus credit and debit may cancel out each other unless there are circumstances to indicate that withdrawal is utilized for purposes other than re-introduction. The peak credit theory should normally be applied to non-genuine entries and not to genuine ones. Where there are many credits, all treated as non-genuine, withdrawal from one account should be treated as available for credit in another. In Bhaiyalal Shyam Behari v CIT (2005) 276 ITR 38 (All.) the High court upheld the view of the Tribunal that working of the peak should be confined to credits and withdrawals in accounts admittedly non-genuine. Similarly, the Income Tax Appellate Tribunal , Bench "A", Kolkata in case of Dilip Kumar Nahata vs. Department of Income Tax in its order dated 09.05.2012 held that when there are six undisclosed bank accounts, while assigning the peak credit the proper method is to make a consolidated fund flow statement by taking into account of all the undisclosed bank accounts and after setting off contra entries, if any, and then the peak credit of these consolidated bank transactions should be taken as undisclosed income of assessee. The ld. CIT(A) ought to have accepted the consolidated peak of all the bank accounts taken together as undisclosed income of assessee instead of aggregate of the separate peak of the individual bank accounts.

The question normally arises as how to determine peak in a given situation. It can be described in the manner that ,all the cash deposits and withdrawals, owned up by the assessee as undisclosed, are placed in chronological order. The balances are drawn against each deposit and withdrawal. The deposit in the first entry becomes closing balance against that first entry. This closing balance of first entry becomes opening balance for second entry. Deposit or withdrawal of the second entry is adjusted to the opening balance. Then closing balance against the second entry is drawn. This closing balance of second entry becomes opening balance of the third entry and so on. Highest closing balance against any entry in the accounting period, arising after such adjustment of deposit/withdrawal becomes the peak in the accounting period.

Based on above discussion, one may list the Salient features of theory of peak credit as under

- The assessee has to admit, for getting the benefit of peak, that borrowings made by the assessee from cash creditors are borrowings from non-genuine creditors, the payments or outgo was only to himself in the form of withdrawals and the payees were also bogus.
- Where the assessee claims that all the deposits are genuine, the benefit of peak will not be available. [refer- Bhaiyalal Shyam Behari v. CIT [2005] 276 ITR 38 (All.)]
- Also, where Revenue is able to prove the particular withdrawal is not available for redeposit/ recycling, the benefit of peak will not be available.
- Unaccounted cash may be introduced in the books either as cash credit or as trade credit. Both of them can be assessed as deemed income. Both can be assessee's own money. Therefore, concept of peak would apply to trade credit also provided it is non-genuine.
- Where books of account are rejected, and profits are estimated then it will not be correct on the part of the AO to work out peak on the basis of such rejected book of account and make separate addition. [refer- CIT v. K.M.N Naidu [1996] 221 ITR 451 (Mad.)]
- Where peak credit theory was applied in preceding year, and there was no change of circumstances in the subsequent year, then theory of peak credit could be applied in subsequent year also. refer- ITO v. Niteshkumar R Dalwadi [IT Appeal No. 53 (Ahd.) of 2013, dated 11-2- 2014]
- On the facts of that peculiar case it was held that peak credit could be applied only in the case of squared up accounts. It is because it is presumed that payments were made to the same person from whom deposits were received. [refer- CIT v. D.K. Garg [2017] 84 taxmann.com 257/250 Taxman 104/404 ITR 757 (Delhi)]
- Where assessee was admittedly engaged in the business of giving accommodation entries and there were deposits of cash and issue of cheques then, question of owning all the deposits and outgo would not arise, i.e., money would not belong to the assessee and therefore, peak credit theory would fail. [refer Bhagdev Roy (supra)]. It has been held by the Hon'ble Delhi High Court in CIT v. D.K. Garg [2017] 84 taxmann.com 257/250 Taxman 104/[2018] 404 ITR 757 (Delhi) that –

"If the Assessee as a self-confessed accommodation entry provider wanted to avail the benefit of the 'peak credit', he had to make a clean breast of all the facts within his knowledge concerning the credit entries in the accounts. He has to explain with sufficient detail the source of all the deposits in his accounts as well as the corresponding destination of all payments from the accounts. The Assessee should be able to show that money has been transferred through banking channels from the bank account of creditors to the bank account of the Assessee, the identity of the creditors and that the money paid from the accounts of the Assessee has returned to the bank accounts of the creditors."

- Where deposits were made outstations, viz, Gujarat, Ujjain, Varanasi, Lucknow, Hyderabad, Amrawati, Hubli, Kozhikode, etc., assessee was in the line of sale of bearings and it was contented that deposits were made by outstation buyers of bearings, and cash was withdrawn only from bank account in Delhi, it could not be said that such withdrawals were available for depositing in bank account in far flung areas. Hence, peak credit theory would not be applicable. [Vineet Kumar v. ITO (IT Appeal No. 6993 (Delhi) of 2013, dated 27-6-2016)]

- Where cash was deposited in a bank account, whereas most of the withdrawals were by inward clearing and there were only few instances of cash withdrawals, peak theory would not be applicable. [refer- Shivraj Mishrilal Bafna v. ITO (IT Appeal No.434/PN/2013)]

- Where depositors are different and recipients are different other than the assessee, the theory of peak credit cannot be applied. In Bhaiyalal Shyam Behari (supra) it was held as under-

  "For adjudicating upon the plea of peak credit the factual foundation has to be laid by the assessee. He has to own all cash credit entries in the books of account and only thereafter the question of peak credit can be raised. As in the present case the amount of cash credits were standing in the names of different persons which all along the applicant had been claiming to be genuine deposit, withdrawal/payment of the amount to different set of persons during the previous years would not at all entitle the applicant to claim benefit of peak credit."

  Similar view was taken by the Hon'ble Punjab & Haryana High Court in Sudhir Kumar Sharma (HUF) v. CIT [2014] 46 taxmann.com 340/224 Taxman 178, where cash was deposited in the 5/6 bank account and thereafter cheques were issued to different parties, the assessee was unable to explain the source of cash deposited in his bank account, i.e., by issuing the cheques to different parties, it could not be said that same was available for redeposit in his bank account.

- Sometimes Peak theory may be interpreted as a kind of telescoping. This is because at the root of both concepts, the principle of adjustment of inflow against outflow, or explanation of outflow from inflow is involved. In telescoping, generation of income, whether in the current year or in the earlier year, is considered as inflow and investment in assets, or cash credits in the books are considered as outflows. In peak, money from earlier withdrawal is considered as inflow and cash credit is considered as outflow and, hence, both are sought to be adjusted or outflow is sought to be explained from the inflow. However , there is a distinction between telescoping and peak.

  Telescoping is adjustment of one income against other, so that same income is not taxed twice. In peak, the withdrawal of cash, if not utilized elsewhere, is considered as available for making deposits. The highest unexplained cash deposit is considered as peak. The determination of peak reduces the taxable income. However, where withdrawals are through cheques and it is not proved that such withdrawals have come back to the pocket of the assessee, then benefit of those withdrawals will not be available to explain the deposits. The crux in applying peak credit theory is a reasonable certainty that withdrawals have not gone elsewhere, either as investment in some assets, or meeting some expenditure, or to the pocket of other person. Even in cases where deposits and withdrawals are in several accounts (in the name of different persons), and assessee owns all these accounts as his own and transactions therein as non-genuine and there is no evidence that outflow has gone to any other person or any other purpose, then cumulative account of all the accounts put together can be drawn and peak there under be determined.

Telescoping and Addition under section 69C

As per the provisions of section 69C of the Act, in case the assessee fails to explain the source of expenditure or part thereof to the satisfaction of the AO, such expenditure shall be considered as unexplained expenditure and be deemed to be income of the assessee. Whenever any addition is made by the assessing officer during the assessment proceedings with regards to undisclosed income and assessee claims that expenditure is made out of such income, then no further addition can be made by invoking provision of section 69C. The benefit of telescoping is to be given in such cases. The Bombay high court in the case CIT v. Golani Brothers (2018) 300 CTR 245 , held that , If the unaccounted expenditure incurred is from the 'on money' received by the assessee, then, the question of making any addition under section 69C does not arise because the source of the expenditure is duly explained. It is only the 'on money' which can be considered for the purpose of taxation. Once the 'on money' is considered as a revenue receipt, then any expenditure out of such money cannot be treated as unexplained expenditure, for that would amount to double addition in respect of the same amount.

Telescoping and Bogus Purchases

Assessee need to establish the source of purchases in cases of bogus purchases, otherwise the benefit of telescoping could not be availed. The Madras High court in the case of Grand Bazzar v. ACIT 292 ITR 269 held that the assessee had not explained as to the source of purchases and the additions under section 69C of the Act are, therefore, justifiable. Further, the Commissioner of Income-tax (Appeals) is not justified in reducing/deleting the additions. As rightly observed by the Tribunal, the funds introduced by the assessee as cash credits in the books of account had gone into the assessee's business account and so, the same could not have been utilised for making the unaccounted purchases and the assessee could not be given credit to any amount already introduced as credits in the account books as available to meet any unaccounted expenditure including the unaccounted purchases. We are, therefore, of the opinion that the Tribunal was justified in restoring the additions under section 69C of the Act for both the assessment years.

Claim of benefit of telescoping in respect of undisclosed income offered by one person in the hands of another person

The question may arise as to whether the Claim of benefit of telescoping can be made in respect of undisclosed income offered by one person in the hands of another person. The Ahmedabad ITAT in the case of Rajni M. Patel v. DCIT (2015) 43 ITR (Trib) 628 held it very clearly that it is possible to claim the benefit of telescoping in respect of undisclosed income offered by one person in the hands of another person. While granting the benefit of telescoping in the hands of the partner in respect of amounts offered and taxed in the hands of the firm, it was held that once an estimated addition on account of household expenses, investment in land, investment on foreign travel are being made and the source of such expenditure is stated to be flowing from the firm which has suffered tax as undisclosed income, then, telescopic benefit should be given to the total amount flowing from the firm as a share of profit coming to the assessee from the firm. In effect, it was held by the Tribunal that the quantum of the amounts available for the benefit of telescoping should not be restricted only to the specific amounts disclosed by the assessee as unexplained expenditure, etc., but the entire share of profits which would have been available to the assessee as a partner of the firm which has already suffered tax on its undisclosed profits.

In another case , when the search operation was carried out on a group as a whole, income taxed in the hands of one person of the group could be telescoped and set-off against income from another person in the same group. It was held by the Hyderabad ITAT in the case of J. B. Education Society v. ACIT 159 TTJ 236, that where the manager of the assessee, an educational society, was in a position to collect money from students who were admitted in assessee's college and he used his position to collect amount in excess of prescribed fee from students and while passing assessment order same was treated as undisclosed income in his hands, the said unaccounted receipts could not again be taxed in hands of the assessee as well.

In this case assessee being society was running medical and engineering colleges and collected certain amount from students over and above the prescribed fees. Manager of the assessee-society stated that amounts were collected and received by him without knowledge of Management Committee. Assessing Officer taxed amount in hands of assessee-society. It was held that the addition is not justified. Amount collected could not be considered exclusively relating to assessee as manager agreeing to withdraw appeals against assessment and pay tax if amount added as income of assessee-society were to be deleted. The manger Sri R Kondal Rao accepted the receipt of money without the knowledge of the assessee by using his position in the assessee's office. Sri R. Kondal Rao has accepted that all the money which has been received would be accepted as his income and he owns the entire responsibility and accordingly disclosed the same to the department and he would pay the tax. Therefore, these impugned receipts cannot be considered to be exclusively relating to the assessee, especially when Sri R.Kondal who has admitted that he has collected money and also admitted to pay the tax on it. In the event of Sri R.Kondal paying the tax on the unaccounted income from the receipts in his hands then the same unaccounted receipts cannot be brought to tax in the hands of the assessee. Accordingly, to the extent of unaccounted receipts which were considered in the hands of Sri R. Kondal, the same cannot be treated as unaccounted income in the hands of the assessee once again. In other words, the receipts as per seized documents accepted to have been collected by Sri R. during the course of search action as well as before Tribunal and offered for taxation by Sri R., cannot be considered in the hands of the assessee once again in the event he complied with the payment of tax. Accordingly, the Assessing Officer shall pass fresh order on this issue after giving an opportunity of hearing to the assessee.

In view of the above precedents, it is quite clear that it is possible to claim the benefit of telescoping in respect of undisclosed income offered by one person in the hands of another person

Addition under section 68 and Telescoping

The situation may arise that cash credits be deemed to have origin in the added income. In the case of CIT v. Singhal Industrial Corporation 303 ITR 225(All) the assessee, a partnership firm was deriving income from the business of manufacture/assembly of diesel engine sets and diesel generating sets. For the year under consideration, the assessing authority made two additions one for Rs. 1,50,980 towards undisclosed profit on the sale of fuel injector equipment and a sum of Rs. 89,500 towards unexplained cash credit under the head 'Dealership Security Account'. The CIT (Appeals) reduced the addition of Rs. 1,50,000 to Rs. 89,000 and has deleted the addition towards unexplained cash credit for Rs. 89,500. CIT (Appeals) found that the sale out of the books has been ploughed back in the form of deposits. A separate addition for the same would accordingly be deleted. It was held that sale out of the books had been ploughed back in the form of deposits and the separate addition for the same could be deleted, has not been challenged by the revenue before the Tribunal. The effect of the finding of the CIT (Appeals) is that it has been accepted that the sale out of the books of account has been deposited in the form of cash credit. The addition in respect thereof at Rs. 89,500 has been sustained, therefore, the CIT (Appeal) and the Tribunal have not deleted the addition made by the assessing authority as an unexplained cash credit under section 68 of the Act as it was explained, but it has been deleted on the ground that the deposits were out of sale made out of the books of account and the addition to that extent has been sustained. There was no error in the view of the Tribunal inasmuch as the revenue before the Tribunal has not challenged the view of the Commissioner (Appeal).

Income taxed in earlier year telescoped to subsequent year

There could be situation where income is taxed / addition is made to taxable income in an earlier year. In such cases, the assessee may claim that the income arising in subsequent year / subsequent period is sourced out of the income taxed earlier.

The Courts have responded differently on different occasions but at least on one point there is a judicial consensus - that the amount represented by the intangible additions constitutes a real and not merely a hypothetical fund which can be utilised subsequently for expenditure or for bringing into the books of account. Differences exist as to the necessity of establishing a nexus between such fund and the introduction of such fund into the books and as to the manner of proving such nexus. As to the latter, no strait- jacket formula has been so far devised nor stated to be possible. It all depends upon the facts and circumstances of the case as held by the various High Courts and the Supreme Court. Mostly, the High Courts have adopted the hands-off attitude leaving the matter of satisfaction of nexus upon the highest fact-finding body - the Tribunal.

In the case of CIT v. Jawanmal Gemaji Gandhi 151 ITR 353 (Bom) , the assessee was a dealer in gold ornaments. The excise authorities seized and confiscated certain quantity of gold from the assessee. The value of the gold was added as income from undisclosed sources and other intangible additions were also made in the same assessment year on the basis of estimated rate of gross profit and turnover. It was held that secret profits or undisclosed income of an assessee earned in an earlier assessment year can constitute a fund, though concealed, from which the assessee may draw subsequently. In the this case, the assessee acquired the gold during the latter half of the assessment year and it could be that the undisclosed income earned in that very year constituted a fund from which the asset was acquired. The assessee had adopted this stand and had contended in the alternative that the source of the gold could be assumed to have come out of the intangible additions on account of increased turnover. Therefore, it was held that the Tribunal was justified in deleting the addition of the amount as income from undisclosed sources.

Similarly, in the case of Kuppuswami Mudaliar v. CIT 51 ITR 757(Mad), it was held by the Madras High Court that where the Income-tax Authorities make an addition to the income of the assessee over and above the income as disclosed by the assessee, on an estimate basis, the amount so added must be treated as the real income of the assessee. It is not open to the authorities to take the view that the addition was only for purposes of taxation and that it should not be regarded as the true income of the assessee. In this case ,the assessee was taxed on substantial undisclosed income in the past years, the same could be treated as income available with the assessee and an addition as undisclosed income in the subsequent year could be telescoped in the undisclosed income taxed earlier. Similar view was adopted in case of *CIT v. Tyaryamal Balchand 165 ITR 453 (Raj).*

Interestingly, in case of *CIT vs. Sharraf Trading – (2015) 376 ITR 534 (Allahabad),* the Hon'ble High Court has gone a step further and held that even peak credit taxed in the earlier year is available for telescoping against peak credit worked out in the subsequent year and therefore not taxable. In fact, quite somewhat similar view is expressed by the Central Board of Direct Taxes [“the CBDT” for short] itself on income disclosed and declared under the Income Disclosure Scheme of 2016 in its Circular No. 29 of 2016 dated 18-8-2016

Though the above precedents have conclusively held that the funds represented by 'intangible additions' exist in reality, yet a person bringing the same into his books has to do quite a tight-rope walk. Firstly, the appellate authorities as well as the Courts may not buy the argument that the unexplained credits represent the intangible additions of the past without any proof of the nexus. Secondly, what degree of proof will satisfy the authorities/Courts can only be a matter of speculation.

The assessees purposely bringing the secret funds representing 'intangible additions' into the 'main stream' run a serious risk. But where an assessee is caught on the wrong foot because of his inability to 'explain' the credits in his books, the 'telescoping theory' definitely helps their case. Be that as it may, there should be a 'humane approach' to the issue by the authorities and the Courts as the assessee is already subjected to tax on the income represented by 'intangible additions. The assessees on their part should provide circumstantial evidence in the form of affidavit and the final accounts and assessment orders for the interregnum period or any other plausible evidence to prove that the amounts have not already been spent and this fact should be brought to the fore before the lowest possible authority.

<u>One type of income already taxed could be telescoped into another</u>

There could be a situation where there are two different additions, one on account of suppression of profit and another on account of cash credit, it is open to the assessee to explain that the suppressed profits had been brought in as cash credits and one has to be telescoped into the other resulting only in one addition. In the case of CIT v. K.S.M. Guruswamy Nadar and Sons, it was held by the Madras High Court that that the Tribunal was right in its view in telescoping the additions made towards the cash credits. – [*CIT v. K.S.M. Guruswamy Nadar and Sons (1984) 149 ITR 127 (Mad)]*

The tax payer may also consider the following other general features of telescoping in dealing with the facts of the respective situation.

- Source of deposit, or of cash inflow, is explained through gross profit additions. The Hon'ble the *Allahabad High Court in CIT v. Banwari Lal Banshidhar [1998]* 229ITR 229, wherein, it was observed: —

  ". . .When the gross profit rate is applied, that would take care of everything and there was no need for the Assessing Officer to make scrutiny of the amount incurred on the purchases by the assessee."

- The benefit of telescoping would not be available in a case where undisclosed income in earlier years was not assessed. [refer- *CIT v. Sharraf Trading Co. [2016] 67 taxmann.com 176/[2015] 376 ITR 534 (All.).* It is pertinent to refer to the observations of Hon'ble Allahabad High Court as under-

  "A concealed income which was neither disclosed in the assessment proceedings nor in any other ancillary proceeding for any earlier year can hardly constitute a source for a subsequent credit entry and if the explanation of the assessee that the source of the credit entry is the undisclosed income of the earlier years is accepted, it will open the doors of the tax evasion and the purpose behind the enaction of s. 68 will be easily defeated."

- Wherever assessee is successful in getting the benefit of telescoping, his income may be reduced but case of the Revenue for levying penalty is strengthened

- Assessee is entitled to raise an alternative plea of non-taxability of certain income on the ground of telescoping for the first time even before the First Appellate Authority In the case of *Addl. CIT v. Dharamdas Agarwal 144 ITR 143 (MP)*, it was held that when cash credits were treated as income from undisclosed sources, the assessee can take an alternative contention before the Appellate Assistant Commissioner that the cash credits were out of undisclosed income taxed in earlier years and the assessee is entitled to raise such alternative plea before the Appellate Assistant Commissioner for the first time.

In fact, in a case before the Hon'ble Supreme Court*CIT vs. S. Nelliappan – (1967) 66 ITR 722 (SC)*, the ground relating to telescoping of additions was urged only in the second round of proceedings before the Tribunal. Revenue's contention before the Hon'ble Supreme Court was that the Tribunal was not competent to allow the assessee's appeal on a ground not raised in the memorandum of appeal. The said contention was rejected by the Hon'ble Supreme Court.

- It is suggested that telescoping may be opted by the assessee only for the year of search or survey or for the years for which return has not been filed. For the years for which the assessee has already filed returns by the time of search or survey, opting for telescoping may involve invocation of penal provisions. In matters involving earlier years it is suggested that the plea for such telescoping may be raised as an alternative ground only if the facts otherwise necessitate such plea.
- Investment in later years is explained by intangible additions of earlier years, unless it is proved by the Revenue that such additions were not available for investment in subsequent years.
- Where inflated expenses had been introduced in the books as bogus cash credits, the benefit of telescoping would not be available against addition on account of investment, as such inflated expenses are already neutralized. [*refer- CIT v. K. N. Satyapalan [2001] 247 ITR 105/[2000] 110 Taxman 151(Ker.)]*
- The benefit of telescoping would be available when both the additions are reasonably relatable to the material on record.
- Where assessee disputes both the additions, the benefit of telescoping may not be available
- Where benefit of telescoping is allowed, it would raise a substantial question of law. [refer- *CIT v. Five Stars Holidays [2007] 294 ITR 54/[2008] 167 Taxman 231 (Delhi)]*

It should be well understood that taxpayer should keep in mind that both the peak credit and telescoping theories have to be applied after appreciating the facts of each case and neither of the theory is readily available in every case as these are not the propositions of the law. The burden of proof lies on the assessee to explain the application of such plea in the fact of the case. The basic principle behind the theories is that there should not be overlapping additions and only the actual and real income of the assessee is taxed.

INTRICACIES OF SECTION 69, 69A AND 69B OF THE INCOME-TAX ACT, 1961


CA Bhakti Maru
Email : marubk1995@gmail.com
CA Rushi Shah
Email : shahrushi2@gmail.com

"The concept of tax avoidance is as old as taxing statue"

Taxation is a crucial source of income for the exchequers. Tax collection flourishes government treasury to fund infrastructure development and social welfare measures. However, taxes are perceived as cost for the taxpayers. The hunt and exploitation of loopholes and gaps in taxing statues is well-known reality. With wisdom accumulated over a period of time, the legislature has installed various tools to plug the loopholes and provide strict penal consequences for tax avoidance.

The High Courts have upheld the legislative power of the Parliament to enact a law dealing with measures for prevention of tax evasion. [1]Section 68 to section 69D are some of the anti-avoidance provisions enacted under the Income-tax Act, 1961 ('the ITA') to deal with income from undisclosed sources. At the outset, it would be important to understand the scope and interplay of different provisions of Section 68 to 69D of the ITA. If the taxpayer has earned income from undisclosed sources, credited to books of accounts, such income would be taxable under section 68. If the income is not credited to books of accounts, but invested and not recorded, it would be taxable under section 69. If the unreported income is not invested but such income is represented by money or jewellery or other valuable article, it would be taxable under section 69A. If the books of accounts reflect investment or money or valuable articles, however, the actual amount invested or expended is higher than the amount reflected in books of account, the excess of actual investment over the amount reported in books of accounts would be taxable under section 69B. If the taxpayer has incurred any expenditure and the taxpayer fails to provide explanation regarding nature and source of such expenditure to the satisfaction of assessing officer, such expenditure would be deemed to be income taxable under section 69C. Where any amount is borrowed on a hundi from, or any amount due thereon is repaid to, any person otherwise than through an account payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person taxable under section 69D.

This article captures nuances and intricacies of Section 69, 69A and 69B.

[1]Ashoka Sharan v. CIT [1994] 209 ITR 679 (Patna)

Comparative analysis of Section 69, 69A and 69B of the ITA			
Particulars	**Section 69**	**Section 69A**	**Section 69B**
Tax subject	Unexplained investments	Unexplained money, etc.	Amount of investments, etc., not fully disclosed in books of account
Taxable in year	Year of investment	Year in which the taxpayer is found to be owner of money, etc.	Year of investment or year in which the taxpayer is found to be owner of money, etc.
Opportunity of being heard	Mandatory		
Rate of tax	60% of taxable income[2]+ surcharge @ 25% + cess @ 3% = 77.25%		
Claim of deduction / set-off	No deduction of expenditure or allowance or set-off of loss is allowed		
Penalty (other than penalty leviable for specified previous years in search cases)[3]	10% of taxes payable[4]. However, no penalty if taxpayer voluntarily includes the income in his return and pays advance tax		

Section 69 to 69B of the IT Act create a deeming fiction. Section 69 of the ITA deals with taxation of unexplained investments. Where the taxpayer has made investments which are not recorded in the books of account, if any, and the taxpayer fails to offer an explanation about the nature and source of the investments to the satisfaction of the assessing officer, then such investment would be taxed under section 69 of the ITA, as income of the taxpayer in the year of investment.

Similarly, section 69A deals with taxation of unexplained money, jewellery, bullion, valuable articles, etc. The deeming provisions of section 69A will come into play if the taxpayer is found to be the owner of the valuable articles and the taxpayer fails to furnish explanation regarding nature and source of such valuables to the satisfaction of revenue. If the taxpayer is found to be in possession of valuable articles, then the presumption under Section 110 of the Evidence Act, 1872, is that he is the owner of such assets. This presumption is rebuttable and the onus is on the taxpayer to prove that he is not the owner of the money or valuable items found in his possession. [5]If the taxpayer proves so, then mere possession of such items by the taxpayer (without ownership) would not be sufficient to trigger rigors of section 69A.Further, mere loose slips can neither prove possession nor ownership of any valuable article mentioned in the slip and hence, it cannot form base for taxation under section 69A[6].

[2]Section 115BBE
[3]In case of search cases, the penalty for specified previous years will be levied as per section 271AAB. For non-specified previous years, penalty will be levied as per section 271AAC.
[4]Section 271AAC – applicable from AY 2017-18.
[5]Chuhadmal Takanmal v. CIT [1987] 166 ITR 12 (Mad HC) affirmed by Supreme Court in Chuharmal v. CIT [1988] 172 ITR 250 (SC)
[6]CIT v. Ravi Kumar [2007] 294 ITR 78 (P&H HC)

Section 69B deals with the scenario where the amount invested/expended on making investments or on acquiring bullion, jewellery or other valuable article exceeds the amount recorded in this behalf in the books of account maintained by the taxpayer for any source of income. If the taxpayer fails to provide satisfactory explanation regarding such excess amount, then it would be taxable under section 69B of the ITA. Let's say, Mr. A has bought a property for Rs. 1 Cr. However, the books of accounts of Mr. A reflects its cost at Rs. 75 lakhs only. The difference of Rs. 25 lakhs would be deemed to be income taxable under section 69B of the ITA.

Common features of Section 69, 69A and 69B[7] of the ITA

- **The specified sections are deeming provisions**

  The phraseology of specified sections creates a deeming fiction. Section 69 and 69A operate on presumption that if a person makes an investment in a particular financial year or is found to be the owner of any money, bullion, jewellery or other valuable article, then the amount so invested must represent either his current income or his savings from past income or receipt by loan or otherwise from some other person. If such person fails to explain the source of investment or money or valuable article, the reasonable conclusion can be a presumption that such investment or money or valuable articles are financed from unreported income. Basis on the same presumption, section 69B of the ITA deems excess of amount expended in investment or owning money, valuable articles, etc. and the amount recorded in this behalf in the books of account, as income of the taxpayer.

- **Onus of proof and opportunity of being heard**

  Identification of unexplained or undisclosed investment or money, bullion or valuable items would not automatically result into addition under the specified sections. The specified provisions clearly articulate the onus of proof and applicability of principles of natural justice.

  The initial onus lies upon the revenue to raise a *prima facie* doubt on the basis of credible material. The onus, thereafter, shifts to the taxpayer to prove that the transaction is genuine and if the taxpayer is unable to offer a credible explanation, the Assessing Officer may legitimately raise an inference against the taxpayer. If, however, the taxpayer furnishes all relevant facts within his knowledge and offers a credible explanation, the onus reverts to the revenue to prove that these facts are not correct[8].

  The rigors of specified sections would apply, only after granting an opportunity of being heard to the taxpayers. The taxpayer is allowed to explain the nature and source of the unexplained or undisclosed investment or money, bullion or valuable items. The assessing officer is obliged to apply independent mind to the explanation furnished by the taxpayer. The assessing officer is bound to examine all documents including cash flow statements, and evidence on merits. Whether the explanation of the taxpayer should be accepted or not, is question of fact. If the taxpayer fails to furnish explanation regarding nature and source of such investment or money, bullion or valuable items, to the satisfaction of the assessing officer, such investment or money, bullion or valuable items would be taxed under the specified provisions.

  In case of cash gift/loan where the borrower/donee has not recorded the transaction in his books of accounts (if any), then practically, the nature and source of gift/loan are to be justified by proving identity and creditworthiness of the lender/donor and the genuineness of the transaction. If the asset is bought by the taxpayer, then the taxpayer needs to substantiate the source of funds used for purchasing that asset. In all these cases, the genuineness of transaction may be verified by the assessing officer by looking into the aspect of human probabilities and surrounding circumstances.

[7] Section 69, 69A and 69B are collectively referred as 'Specified sections'
[8] CIT v. Jawaharlal Oswal [2016] 382 ITR 453 (P&H HC)

- **Year of taxability**

The unexplained or undisclosed investment or money or valuable items could be result of undisclosed income of the current year or past years. Hence, where such undisclosed income is identified, question arises regarding year of taxability of such income. The undisclosed / unexplained investment under section 69 and 69B would be deemed to be income of the year in which the investment is made. On the other hand, the undisclosed / unexplained money, bullion or valuable items under section 69A and 69B would be deemed to be income of the year in which the taxpayer is found to be owner of such money or valuable items.

The relevant date for assessment under section 69A would be the date on which the taxpayer is physically found to be in possession of the money, etc., and not the date on which the finding about ownership is recorded. Such a finding, whenever recorded, would refer back to the date of recovery. For instance, if a theft is committed on a particular date but a finding relating to this is given subsequently, may be after one or two years, the commission of the offence of theft would relate back to the date on which it had been committed, and it would not be connected with the date of the finding arrived at in this context[9].

- **Discretionary power conferred to the assessing officer**

The specified sections grant discretionary power to tax the undisclosed / unexplained investment / money or bullion or valuable items, if, the explanation falls short to the satisfaction of assessing officer. The assessing officer is not obliged to treat investment or money, valuable article etc. as income in every case where the explanation offered by the taxpayer is found to be not satisfactory. The assessing officer can exercise his discretionary power to tax the income, basis on the circumstantial evidence surrounding each case. The tax officer must exercise his discretion in a judicious manner[10].

- **Relevance of books of accounts**

Section 69 and 69A target unexplained investments and unexplained money, bullion or valuable items, which are not recorded in books of accounts, if any, maintained by the tax payers. Thus, maintenance of books of accounts is not a relevant factor for Section 69 and 69A of the ITA. Section 69 and 69A would apply, irrespective of the fact, whether the taxpayer maintains books of account or not, to the extent such investment or money, bullion or valuable items, are not recorded. No necessity of rejection of books of accounts to tax under section 69 or 69A of the ITA. [11]However, section 69B stands on different footing. Section 69B compares the value recorded in books of accounts for such investment or money, bullion or valuable items, with the actual amount invested or expended. Accordingly, if the investment or money, bullion, or valuable items are not recorded in books of accounts, section 69 and 69A would apply. However, if the investment or money, bullion or valuable items are recorded at an amount lower than the actual amount invested or expended, such excess of actual amount invested or expended would be taxable under section 69B of the ITA.

[9]Patoa Brothers v. CIT [1982] 133 ITR 672 (Gau.)
[10]CIT v. Smt. P.K. Noorjahan [1999] 237 ITR 570 (SC)
[11]Unit Construction Co. Ltd. v. JCIT [2003] 260 ITR 189 (Calcutta)

- **Quantum of addition**

No additions under specified sections can be made basis on surmises or conjectures but on concrete material[12]. Section 142A of the ITA empowers the assessing officer to make a reference to a Valuation Officer to estimate the value, including fair market value, of any asset, property or investment. The assessing officer, may after grating opportunity of being heard to the taxpayer, may take such value for the purpose of addition under specified section. Assessing officer can make reference to the Valuation Officer even if, he is satisfied about the correctness or completeness of the accounts of the taxpayer. However, mere difference in the valuation report and value reported in books of account will not be conclusive evidence of undisclosed investment or money, bullion or other valuable items.

Section 69 creates a charge against amount invested for acquisition of investment and not against fair market value. Fair market value of the investment or valuable items cannot be equated with the cost. Determination of fair market value is not equivalent to determination of investment i.e. what is actually spent by the taxpayer in a year of acquisition[13.]

- **Other Aspects**

It is settled principle that same income cannot be taxed twice in the hands of same taxpayer. Basis that, many times, the taxpayers also argue that the source of money, valuable article etc. is the intangible additions made in the preceding years and hence, addition under specified sections should be dropped. The undisclosed / unexplained investment or money, bullion or valuable items is representation of intangible additions made during the assessment proceedings of preceding previous years.

However, the taxpayer needs to establish that he has not earned any secret profits during the relevant year and that the asset has come from the intangible additions made in the preceding year. The secret profits or undisclosed income of an taxpayer earned in an earlier assessment year may constitute a fund, even though concealed, from which the taxpayer may draw subsequently for meeting expenditure or introducing amounts in his account books. The mere availability of such a fund cannot, in all cases, imply that the taxpayer has not earned further secret profits during the relevant assessment year[14]. Assessment proceedings initiated or made for the preceding previous years would not automatically safeguard the taxpayers from the clutches of specified sections[15].

- **Interplay of Section 68 and Section 69**

It is important to understand interplay of section 68 and 69 of the ITA. Section 68of the ITA[16] deals with taxation of cash credits including share application money, share capital, share premium or any such amount credited in books of accounts of a closely held company[17], or loan or borrowing. If the recipient of the fund, fails to provide explanation regarding nature and source of such transactions to the satisfaction of the assessing officer, it would be taxable under section 68 in the hands of the borrower / investee company. However, such share application money, share capital, share premium or loan or borrowing would constitute 'investment' in the hands of lender or shareholder. If such investment is not recorded in the books of accounts of the lender or shareholder, any failure on the part of the lender or shareholders to explain nature and source of the investment would again be taxed under section 69 of the ITA. Hence, it may lead to double taxable.

[12] Victoria Foods (P.) Ltd. v. DCIT [2010] 3 ITR(T) 35 (Delhi)
[13] CIT v. Roshan Lal Seth [1989] 178 ITR 660 (Punjab & Haryana)
[14] Anantharam Veerasinghaiah& Co. v. CIT [1980] 123 ITR 457 (SC)
[15] Smt. Kamala Devi Jhawar v. CIT [1978] 115 ITR 401 (Calcutta)
[16] As amended by Finance Act, 2022
[17] Company not being a company in which the public are substantially interested

- **Interplay of Section 69B and Section 56(2)(x)**

  Section 56(2)(x) levies tax on the taxpayer, if he has *inter-alia* received immovable property without consideration or at a price lower than its stamp duty valuation, and the difference between stamp duty valuation and the consideration exceeds Rs. 50,000. Where the taxpayer has invested in immovable property at a cost lower than its stamp duty valuation and the difference is voluntarily offered to tax under section 56(2)(x) of the ITA, can it be again taxed under section 69B? Normally income under section 56(2)(x) would be taxable at slab rates in case of individual or HUF taxpayer or at rate of 22%/ 30% in case of companies / firms. Does it give an arbitrage to offer income under section 56(2)(x) at lower rate of tax and come clean? Can the department go into tax avoidance (substantiated by proof) and tax the difference under section 69B?

  In such scenario, further a question arises whether the department invoke section 69B in each case, wherever the stamp duty valuation is higher than the actual cost reported in books of accounts?

  Here, it would be relevant to observe that section 56(2)(x) takes stamp duty valuation as basis for taxation, whereas no such reference to stamp duty valuation is available under section 69B. The fact that the cost of immovable property reported in books of accounts is lower than the stamp duty valuation, would not be the sole criteria to trigger taxability under section 69B of the ITA. The legal fiction created under section 50C cannot be extended to tax income under section 69B. In order to invoke Section 69B, the revenue has to prove that the taxpayer had paid over and above, what had been recorded as purchase consideration of the land in the instrument, i.e., the sale deed.[18] Further, in absence of any proof of unreported income, the department cannot invoke section 69B and disregard the income offered under section 56(2)(x) of the ITA.

- **Difference between value of stock as per books and statement furnished with bank for loan / overdraft facilities**

  Business avails overdraft / loan facilities from bank with hypothecation of stock and debtors. The borrower is required to furnish monthly statement of stock and debtors. It is well-known malpractice to inflate value of stock to avail higher credit. Interestingly, such practice can land the borrower into trouble with tax department.

  The difference in the value of stock reflected in books of accounts and statement furnished with bank could be taxable under section 69B. However, the judiciary seems to be divided on this subject. Few courts[19] have held that the practice of inflating value of stock to avail higher loan cannot be appreciated by tribunals or courts. Accordingly, such difference would be taxable under section 69B.

  On the contrary, the Courts[20] held that the difference between stock statement and the books of accounts would not be cogent ground to reject method followed by the taxpayer for ascertainment of income. The tribunal accepted practice of preparation of bank stock declaration at market value and preparation of books of accounts at cost. The Tribunal rejected department's plea for treating such difference as undisclosed income, which was upheld by the High Court[21].

  Practically, onus would be on the taxpayer to prove mistake in the stock statement and reconcile the same with the book of accounts or justify the difference through reconciliation. Difference in stock quantity may weaken the taxpayer's case.

[18]ITO v. Harley Street Pharmaceuticals Ltd. [2010] 6 ITR(T) 182 (Ahmedabad - ITAT)
[19]Dhansiram Agarwalla v. CIT [1993] 201 ITR 192 (Gauhati)
[20]India Motor Parts and Accessories (P.) Ltd. v. CIT [1966] 60 ITR 531 (Mad.)
[21]CIT v. Prem Singh & Co. [1987] 163 ITR 434 (Delhi)

- **Head of income and deduction of expenditure**

The applicability of head of income for undisclosed income has been a subject matter of litigation and the judicial view is divided on this issue. The Gujarat High Court in Fakir Mohmed Haji Hasan v. CIT [2001] 247 ITR 290 (Guj) (HC) held that once income is taxed under section 68 to 69D, it will be a headless income. However, when the taxpayer justifies the nature and source of undisclosed income, the deeming provisions of section 68 to 69D cannot be triggered and hence the income will be taxed under the particular head under which that source of income falls. Where excess stock is found in the course of search and survey, some courts[22] have held that investment in excess stock cannot be assessed under section 69B and it has to be treated as business income. Resultantly, the high rate of tax and the bar on deduction of expenditure and set-off of loss is not applicable to such addition on account of excess stock. The Courts[23], in some cases, have also held that the income surrendered in the course of search is arising out of the taxpayer's regular business only and hence has to be assessed as business income.

Vide Finance Act 2022, a new section 79A has been introduced to deny set-off of loss and unabsorbed depreciation ('UAD') against undisclosed income found in the course of search or requisition or survey. Henceforth, though the taxpayer is able to prove the source of undisclosed income found in the course of search, he will not be able to set-off losses and UAD against such undisclosed income. However, if the taxpayer is able to prove the source of undisclosed income, then the taxpayer could still claim deduction of expenditure against the undisclosed income found in the course of search and offer it to tax as per normal rates.

Going forward, the availability of deduction of expenditure/allowance and set-off of loss and UAD is tabulated and summarized below:

Particulars	**Undisclosed income taxable under the specified sections**	**Undisclosed income found in the course of search, survey, requisition and the sources identifiable**
Deduction of expenditure and allowance	Disallowed	Allowed
Set-off of loss and UAD	Disallowed	Disallowed
Rate of tax	Section 115BBE	Applicable rates

[23]CIT vs. Bajargan Traders [ITA No. 258 of 2017 – Rajasthan HC], Chokshi Hiralal Maganlal v. DCIT [2011] 9 taxmann.com 300 (Ahbd-Trib), ACIT v. Sanjay Bairathi Gems Ltd [2017] 84 taxmann.com 138 (Jaipur-Trib), DCIT vs Ram Narayan Birla (ITA No. 482/JPR/2015 for AY 2011-12 dated 30 September 2019)

[24]Oberoi Motors vs ACIT [ITA No. 3512/Del/2018]

- **Taxation of Virtual Digital Asset**

Finance Act, 2022 created stir for investors / traders of crypto currencies and non-fungible tokens ('NFTs'). Section 115BBH, introduced vide Finance Act, 2022, is a self-contained code for taxation of virtual digital assets ('VDAs') and imposes tax at the rate of 30%.Where the taxpayer is found to be owner of the VDAs and he fails to substantiate the nature and source of such VDAs to the satisfaction of assessing officer, question arises regarding taxability of such VDAs under section 69 or 69A. Whether the VDAs could be equated with money, jewellery, bullion or other valuable items or it should attract section 69 in the capacity of investment? Given that the section 115BBH begins with non-obstante clause and code in itself, could it be taxed under section 115BBH? However, the provisions of section 115BBH are applicable, on the transfer of VDAs. Hence, it could be argued that provisions of section 115BBH may not apply on identification of undisclosed / unexplained VDAs. If such undisclosed investment / money or bullion, etc. are to be taxed under specified sections, whether cost of acquisition of such VDAs would be available as deduction at the time of transfer under section 115BBH?

- **Interplay with The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015('the Black Money Act')**

The Black Money Act applies to undisclosed foreign income and undisclosed foreign assets of Indian residents. Now consider a case where the tax officer has made addition under section 69 of ITA on account of unexplained investments outside India not recorded in books of accounts. In such cases, a question arises as to whether the same would also be covered under the Black Money Act. As per section 4(2) of the Black Money Act, any variation made in the income from a source outside India under the ITA in accordance with the provisions of section 29 to section 43C or section 57 to section 59 or section 92C of the ITA, shall not be included in the total undisclosed foreign income under section 4 of the Black Money Act. However, in the above example, variation is made due to some other provision under the ITA i.e. section 69. Hence, section 4(2) would not apply in the instant case. But one should note the provisions of section 4(3) of the Black Money Act. As per section 4(3) of the Black Money Act, the income included in the total undisclosed foreign income and asset under the Black Money Act, <u>shall not form part of the total income under the ITA</u>. The provision in the Black Money Act being a specific legislation to deal with undisclosed foreign income and asset, the same will be applicable in respect of such undisclosed income and asset as against the provision of ITA.

Thus, post 1 July 2015, undisclosed foreign income/assets would be taxable under the Black Money Act and not ITA. But if undisclosed income gets assessed under ITA (for AY 2016-17 onwards) and subsequently proceedings under Black Money Act are initiated, then whether a rectification application under section 154 of ITA or revision petition under section 264 of ITA can be filed by the taxpayer?

- **Interplay with Prohibition of Benami Property Transactions Act, 1988 ('Benami Act')**

Apart from the Black Money Act, it is also relevant to examine the interplay of addition made under section 69/69A/69B with the Benami Act. For instance, if addition is made under section 69 on account of unexplained investment, then whether the same can also be covered under the Benami Act? Here, one can appreciate that the fundamental objective of the Benami law is to catch hold of those assets which are held by a person, who is not the real owner of the asset. In case of assets like money, bullion, jewellery etc, the legal presumption is that possession *is prima facie* proof of ownership. If taxpayer is found to be in possession of the valuable articles, then the presumption is that he is the owner of such assets, unless he proves otherwise. In such cases, if the taxpayer accepts ownership of the money, bullion, jewellery etc, then the tax officer has the right to proceed under section 69A. But the taxpayer would be absolved from applicability of Benami Law. But, if the taxpayer proves that he is not the owner of the money, bullion, jewellery etc, then section 69A would not be applicable, but he may get covered under the Benami Act. In case of assets like immovable property, shares, bonds, debentures where the beneficial owner is different from the registered owner, the provisions of Benami Act may apply; and the assets would be treated as benami property.

- **Demonetization**

On November 8, 2016, the whole country was in shock when the Prime Minister announced the demonetization of Rs 500 and Rs 1000 currency notes. The citizens were provided a deadline of December 31, 2016, to deposit these currency notes in their bank account. Consequently, there were huge cash deposits during this period throughout the country. The Income Tax Officers have issued notices to many assesses asking them to prove the nature and source of such cash deposits. In many cases, the tax officers have made addition of the unexplained deposits under section 69A (if the taxpayer has not maintained books of account or has not recorded in his books of accounts) or section 68 on the ground that the taxpayer has introduced unaccounted cash in its books of accounts in the wake of demonetization. Typically, the taxpayers have argued that the source of cash deposits is amount received on cash sales during the year or cash savings of past years or cash balance in books of accounts. The important observations of the judicial authorities in these cases are summarized below[24]:

i. If the cash balance in books of accounts is sufficient to cover the cash deposited in bank account and the books of accounts are not rejected, then the tax officer cannot disbelieve a part of such cash balance as being not of specified denominations.

ii. It is possible that even in a cash balance of a very large amount there may be no high denomination notes at all. Equally it is possible that even in a cash balance of a small amount almost the entire cash balance may be made up only of high denomination notes. When both the possibilities were there, it could not be said that those or any of them represented the income of the taxpayer from some undisclosed source.

iii. High denomination currency notes could be stored more easily and, at the time of accounting, they would have facilitated counting. Since the balance was increasing steadily, the taxpayer might not have felt it necessary to keep the balance in currency notes of low denomination. Such an explanation by taxpayer is not an unreasonable explanation.

iv. If there is no substantial increase in sales post demonetization compared to earlier years, it cannot be said that taxpayer has booked non-existing sales in its books post demonetization. The cash sales to cash deposit ratio proves that whatever cash sales was recorded by the taxpayer for the year the same was deposited in its bank account. No substantial downfall or increase in the gross profit and net profit compared to earlier years. Since cash sales are as per the business trend of the taxpayer, no addition can be made under section 69A in respect of the cash deposits during demonetization.

[24]Lalchand Bhagat Ambica Ram v. CIT [1959] 37 ITR 288(SC), Gur Prasad Hari Das vs. CIT [1963] 47 ITR 634 (All.), Kanpur Steel Co. Ltd. v. CIT [1957] 32 ITR 56 (All.), ITO v. TatipartiSatyanaraya (ITA 76/Viz/2021), Agson Global Pvt Ltd v. ACIT (ITA 3741-3746/Del/2019), DCIT v. Sri Jaya Prakash Babu Valluri (ITA 31/Viz/2021), Smt Uma Agrawal v. ITO (ITA 35/Agr/2021), Nand Kumar Taneja v. ITO (ITA 4958-4959/Del/2018), DCIT v. Veena Awasthi (ITA 215/LKW/2016), ITO v. Mrs. Deepali Sehgal (ITA 5660/Del/2012), Sudhir Bhai PravinkantThaker v. ITO (ITA NO 788/AHD/2012), ITO v. Baburao K Pisal (ITA 6091/Mum/2012)

v. Considering the past history and nature of business of the taxpayer and the pattern of money deposited pre-demonetization and post that event, no additions can be made in respect of the cash deposits during demonetization.

vi. If assesses have genuine sources of income which are received through banking channels, out of which cash has been withdrawn and have been disclosed in the income tax return and in the balance sheet as cash-in-hand, then section 69A cannot be applicable. Once taxpayer has explained that being a senior citizen they have maintained such liquidity of cash out of their own disclosed income with them for certain contingencies, then addition under section 69A cannot be sustained.

vii. There is no law in the country which prevents citizens to frequently withdraw and deposit his own money. Documentary evidence furnished before the Revenue clearly clarifies that on each occasion at the time of deposit in her bank account, taxpayer had sufficient availability of cash which is also not disputed by the Revenue. Entire transaction of withdrawals and deposits are duly reflected in the bank account of the taxpayer and are verifiable from relevant records.

viii. Merely because there was a time gap between withdrawal of cash from partnership firm account and further deposit into the firm's bank account, the amount cannot be treated as income from undisclosed sources. It is not mandatory under any law of the land that an individual has to keep his/ her savings in the bank account only and not as cash in hand.

ix. From the perusal of the bank statements of the bank accounts of the appellant mentioned above, it can be observed that there are sufficient cash withdrawals from these banks, the credit for which has to be given unless and until it is proved that this cash has been utilized for some other purpose. There is no provision in the ITA requiring that cash once withdrawn has to be redeposited immediately if not utilized. It is well within the right of the appellant to keep the cash withdrawn with him according to the day to day requirements of the business and the businessman cannot be forced to redeposit the same in the bank if not utilized, as long as the proper entries of this cash in the books of accounts have been made. The time gap between the withdrawals and deposits is not of much relevance.

x. Merely on the basis of speculation that the amount might have been utilized for any other purpose and was not available with the taxpayer for making the deposits, it is not open to the tax officer to make the addition on the basis that the taxpayer failed to explain the source of deposits.

Conclusion:

After the demonetization in 2016, the Income Tax Department has initiated 'Project Insight' to track taxpayers who are at high risk of tax evasion. The Department is also using the data available with other organizations such as RBI, GST Department, Registrar of Companies, social networking websites, etc. Further, there has been a significant increase in the search and survey proceedings conducted by the Income Tax Department in the last few years. The objective of all these measures is to unearth the concealed income of the assesses and tackle the menace of unaccounted money. If the taxpayer is successful in explaining the nature and source of such income, then the deeming provisions of section 68 to section 69D would not be applicable. But if the taxpayers are unable to explain the nature and source of undisclosed income to the satisfaction of the tax officer, then it may get taxed at the rate of 77.25% (plus applicable penalty) Thus, the taxpayers need to be very cautious while preparing their books of accounts and other documentation so that they can provide proper justification about the nature and source of undisclosed income.

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OVERVIEW OF SECTION 69C OF THE INCOME-TAX ACT, 1961 – UNEXPLAINED EXPENDITURE

CA Mansi Chheda
Email : mansichheda9@gmail.com

1. INTRODUCTION

During the past years, the Central Board of Direct Taxes ('CBDT') has entered into Memorandum of Understandings with various bodies viz. SEBI, CBIC, Ministry of MSME, etc. to facilitate sharing of data on an automatic and regular basis. The collective use of resources has enabled the Income-tax Department to gather bulk information for conducting enquiries/investigations on businessmen which is likely to lead in increasing litigations.

One such focus area of the Income-tax Department in detecting tax evasion cases is taxation of unexplained expenditure. It is, therefore, imperative to understand the provisions of the Income-tax Act, 1961 ('the Act')dealing with the same and the consequences thereto.

2. PROVISIONS OF THE ACT

The section is reproduced below for ease of reference:

"Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation, if any, offered by him is not, in the opinion of the Assessing Officer, satisfactory, the amount covered by such expenditure or part thereof, as the case may be, may be deemed to be the income of the assessee for such financial year:

Provided that, not withstanding anything contained in any other provision of this Act, such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as a deduction under any head of income."

Key Trigger points:

- Assessee has *incurred expenditure* in any financial year **and**
- Assessee offers *no explanation about the source* of such expenditure (or part thereof) **or**
- *Explanation offered by him is not satisfactory* in the opinion of the Assessing Officer

Consequences:

Such expenditure (or part thereof) may be **deemed to be the income** of the assessee for such financial year in which expenditure is incurred. Further, as per Proviso to section 69C of the Act, such unexplained expenditure shall not be allowed as a deduction under any head of income.

3. LEGISLATIVE HISTORY

3.1. This section was inserted by the Taxation Laws (Amendment) Act 1975, with effect from 1 April 1976.Further, vide Circular No. 204 dated 24 July 1976 it is clarified that though the section comes into force with effect from 1 April 2976, the principle, will apply to assessment proceedings for earlier AY's too (i.e. prior to AY 1976-77).

Proviso to section 69C:

3.2. Finance Act (No. 2) 1998 inserted a Proviso with effect from 1 April 1999 to provide that such *unexplained expenditure shall not be allowed as a deduction under any head of income* not withstanding anything contained in any other provision of this Act.

3.3. Circular No. 772 dated 23rd December 1998 explained the necessity of introduction of such Proviso. It states that as per section 69C of the Act, the expenditure was deemed to be income of the assessee, however, there is no corresponding provision for disallowance of such expenditure. This used to enable the taxpayer whose income was charged to tax under section 69C to claim the expenditure as deduction under section 37 defeating the very objective of the section.

3.4. As per the above Circular, the amendment is effective from 1 April 1999 i.e. for AY 1999-00 and subsequent years. Therefore, there is nothing to suggest that the amendment has a retrospective application.

3.5. The Hon'ble Gujarat High Court in the case of ***Krishna Textiles v. CIT***[2009] 310 ITR 227 (Gujarat) observed that the Proviso to section 69C of the Act did not have retrospective application. Similar view was taken by the Hon'ble Andhra Pradesh High Court in the case of ***P. Ram Gopal Varma v. DCIT***[2013] 357 ITR 493 (AP).

4. KEY ASPECTS

A. ***Incurrence of expenditure***

- The first condition to attract provisions of section 69C of the Act is that assessee should have incurred some "expenditure" during the financial year. The onus is prima facie on the Assessing Officer to prove that expenditure has been incurred by the assessee. However, once Assessing Officer provides some corroborative evidence on the fact that expenditure has been incurred, the burden of proof shifts on the assessee to justify that no such expenditure has been incurred.

- The Hon'ble Delhi High Court in the case of ***CIT v. Lubtec India Ltd.*** [2009] 311 ITR175 (Delhi) has held that,

  *"6…it is quite clear that what is postulated in section 69C of the Act is that **first of all the assessee must have incurred that expenditure** and thereafter, if the explanation offered by the assessee about the source of such expenditure is not found satisfactory by the Assessing Officer, the amount may be added to his income."*

  Further, the Hon'ble High Court noted in that case that there was nothing on record to show that the expenditure was actually incurred by the assessee **nor did the Assessing Officer take any action to find out whether the expenditure was actually incurred or not**. Accordingly, the addition was not sustained.

- Further, in case of ***Pradip C. Patel v. DCIT*** [1997] 58 TTJ 409 (Ahmedabad), the Hon'ble Tribunal has held that:

  - In order to invoke the provisions of section 69C, **the Assessing Officer has to establish the condition precedent as to the existence of expenditure or understatement of that expenditure by evidence and/or material on record to justify the addition**.

- If the Assessing Officer cannot or fails to prove the existence of material indicating the unexplained expenditure or understatement of expenditure, the assessee cannot be taxed.

Therefore, as seen above, the primary criteria for invoking section 69C is incurrence of expenditure by assessee which has to be proved by the Assessing Officer by way of cogent material on record.

Let us look into various issues adjudicated by the Hon'ble Courts/Tribunals in this regard.

- **Addition merely on the basis of loose sheets without any corroborative evidence/material is not sustainable**

  - In case of ***ITO v. Karan R Shah*** (ITA. No. 3652 & 4290/Mum/2015), a loose document was found during survey proceedings which depicted that expenditure to the tune of Rs. 65 Lacs have been incurred by the assessee. The Tribunal deleted the addition made by the Assessing Officer and held that:

    - ❖ The **loose sheet of paper cannot come within the ambit of definition of the word "document" having any evidentiary value** within the meaning of section 132 or section 132A of the Act and the same cannot form the basis for assessing the undisclosed income of the assessee.

    - ❖ **Additions cannot be made simply on the basis of rough scribbling** made by some unidentified person.

    - ❖ When dumb document like the present loose sheet of paper is recovered and the Revenue wants to make use of it, then the **onus rests on the Revenue to collect cogent evidence to corroborate the noting therein**.

  - Similar view has been taken by the Hon'ble Courts in the following cases:

    - *CIT v. Tips Industries (P.) Ltd.*[2010] 321 ITR 154 (Bombay HC)
    - *CIT v. Anil Bhalla* [2010] 322 ITR 191 (Delhi HC)
    - *CIT v. Ved Prakash Choudhary* [2008] 305 ITR 245 (Delhi HC)

- **Addition merely on basis of presumption is not sustainable**

  - In case of ***DCIT v. Narendra Garg & Ashok Garg (AOP)***[2016] 72 taxmann.com 355 (Gujarat), addition was made by the Assessing Officer pursuant to the statement recorded under section 132(4) of the Act which was subsequently retracted.

    - ❖ The Hon'ble High Court held that **it is a settled position of law that if an assessee, under a mistake, misconception or on not being properly instructed, is over assessed, the authorities are required to assist him and ensure that only legitimate taxes are collected**.

    - ❖ The Assessing Officer cannot proceed on presumption under section 132(4) of the Act and there must be **something more than bare suspicion to support the assessment or addition.**

- Similar view has been taken by the Hon'ble Courts in the following cases:
  - *Seven Jewels v. ACIT* (ITA No. 1428/Mum/2021)
  - *ITO v. Suresh Chandra Kothari* [2009] 31 SOT 14 (Jodhpur) (URO)

- **Addition in respect of alleged interest paid on loan taken in cash under section 69C cannot be sustained** as no document or material was filed by Revenue to show in fact that loan was taken and interest was paid - ***CIT v. Home Developers (P.) Ltd.***[2015] 54 taxmann.com 159 (Delhi)
  - In this case, the Assessing Officer relying on certain documents found during search concluded that the assessee had received cash loan and had repaid the same in cash along with interest. He estimated the principal amount of loan and the interest thereon at rate of 20%.
  - The CIT(A) sustained the addition however reduced the interest rate to 18%. The Tribunal noted that addition of quantum and interest both were merely on assumption.
  - The Hon'ble High Court upheld the order of the Hon'ble Tribunal and noted that the allegation that loans/deposits must have been taken in cash was a mere suspicion, which could have been a cause for further verification and investigation, but **mere suspicion cannot be a ground to hold that loan/deposits were received in cash**.

    The Revenue has not filed before us any document or material to show that in fact loan was taken and interest payment was made. **The persons to whom allegedly interest was paid, their details and particulars were not ascertained, verified and examined.**

- **Whether addition under section 69C can be made in case of presumptive taxation under section 44AD? - *Nand Lal Popli v. DCIT*** [TS-6098-ITAT-2016(Chandigarh)-O]
  - In case of the Assessing Officer had not doubted the gross receipts offered by the assessee but presumed that an amount to the extent of 92% of the gross receipts is the expenditure incurred by the assessee.
  - The Tribunal held that asking the assessee to prove to the satisfaction of the Assessing Officer that the expenditure to the extent of 92% of gross receipts has been incurred would also defeat the purpose of presumptive taxation as provided under section 44AD of the Act or other such provision.
  - Some key observations made by the Tribunal are:
    - ❖ If 8% of gross receipts are 'deemed' income of the assessee, the remaining 92% are also 'deemed' expenditure of the assessee.
    - ❖ If the income component is estimated, how the expenditure component on the basis of said income can be considered to have been 'actually' incurred.
    - ❖ The Assessing Officer could have made the addition under section 69C of the Act, once he had carved out the case out of the glitches of the provisions of section 44AD of the Act.

- **Addition of Marriage expenses merely on presumption is not sustainable**

  The Assessing Officer, considering the status of the assessee presumed that assessee might have incurred expenditure on different occasions but nothing was brought on record whether assessee has performed any of such ceremonies which are large in number noted in the assessment order. Therefore, the Tribunal held that **the order of the Assessing Officer was wholly based upon assumptions on certain facts which did not exist and hence, not sustainable. –** ***Subhash Chander Goel v. ITO*** [2016] 65 taxmann.com 216 (Chandigarh - Trib)

B. *Explanation of source to the satisfaction of the AO*

- As seen above, the first condition for attracting the provisions of section 69C is that the assessee has to incur some 'expenditure'. Where assessee is unable to prove that expenditure has not been incurred, we move on to examine whether the second condition is fulfilled or not.

- The second condition is that assessee does not offer explanation about the source of expenditure incurred or the explanation offered by the assessee is not found satisfactory by the Assessing Officer. Only where the source is not considered as satisfactory by the Assessing Officer, he may proceed to deem the expenditure incurred as income of the assessee.

- The Calcutta High Court in case of ***CIT v. Bhagwati Developers (P.) Ltd.*** [2003] 261ITR658 (Calcutta)has held that,

  > *"…section 69C deals with unexplained, source of expenditure. If from documents it appears that there was an expenditure, unless its source is satisfactorily explained, the same would also be deemed to be the income of the assessee for such financial year.* ***The question of addition depends on the satisfactory explanation of the source. It cannot be negated simply because the expenditure was actually incurred. On the failure to explain the source of the expenditure, it is liable to be added****."*

- In case of ***CIT v. Golani Brothers*** [2017] 85 taxmann.com 355 (Bombay), the Assessing Officer made additions on account of "on money" i.e. advance received by the assessee and unexplained expenditure. The Tribunal held that if the unaccounted expenditure so incurred was from the 'on money' received by the assessee, then, the question of making any addition under section 69C does not arise because the source of the expenditure is duly explained. The Hon'ble High Court held that,

  > *"21….* ***If the unaccounted expenditure so incurred was from the 'on money' received by the assessee, then, the question of making any addition under Section 69C does not arise because the source of the expenditure is duly explained****. It is only the 'on money' which can be considered for the purpose of taxation. That is what the Tribunal therefore concluded and once the 'on money' is considered as revenue receipt, then* ***any expenditure out of such money cannot be treated as unexplained expenditure****, for that would amount to double addition in respect of the same amount.*
  >
  > *22…It is a factual exercise which has been performed by the Tribunal and its conclusion that there could not be a double addition given the explanation for the* source of expenditure*, is also a permissible one. It is not as if such a conclusion is unknown to law…."*

The burden of proof for explaining the source of the expenditure lies on the assessee. Therefore, the assessee needs to furnish robust documentation to prove the genuineness of the expenditure incurred. One of the prominent additions made by the Assessing Officer under section 69C is alleged "bogus purchases" which is elaborated in detail below.

- **Addition on account of alleged Bogus Purchases**

Where the Assessing Officer alleges that the assessee has entered into bogus purchases basis information from Sales tax department/ Investigation Wing, the obligation is cast on the assessee to prove that the transactions are genuine. The genuineness of the expenditure may be proved by producing invoices, stock register, lorry receipts/delivery challans, bank statement, correlation with sales etc. Where the assessee is able to prove that the purchases are genuine, the onus shifts on the Assessing Officer to prove that the transactions are bogus.

- In case of ***PCIT v. Chawla Interbild Construction Co. (P.) Ltd*** [2019] 412 ITR 152 (Bombay), the Hon'ble High Court has held that,

> *"7…**assessee had done everything to produce necessary evidence**, which would indicate that the payments have been made to the parties concerned. The details furnished by the respondent assessee were sufficient for the Assessing Officer to take further steps if he still doubted the genuineness of the payments to examine whether or not the payment was genuine. The **Assessing Officer on receipt of further information did not carry out the necessary enquiries on the basis of the PAN numbers, which were available with him to find out the genuineness of the parties.** The CIT(A) as well as the Tribunal have correctly held that **it is not possible for the assessee to compel the appearance of the parties before the Assessing Officer**."*

- <u>Additions merely on the basis of information from Sales tax department/ Investigation Wing without conducing independent enquiry is not sustainable:</u>

  - *PCIT v. Shapoorji Pallonji & Co. Ltd.*[2020] 423 ITR 220 (Bombay)
  - *PCIT v. Vaman International Pvt. Ltd.*(ITA No.1940 of 2017, Bombay)
  - *Shri Ganpatraj A Sanghavi v. ACIT* (ITA No. 2826/Mum/2013)
  - *DCIT v. Shri Rajeev G Kalathil* (ITA No.6727/Mum/2012)
  - *Ramesh Kumar and Co v. ACIT* (ITA No.2959/Mum/2014)

- <u>Only profit element embedded in the transaction can be added to total income:</u>

  - In case of ***CIT v. Simit P. Sheth*** [2013] 38 taxmann.com 385 (Gujarat), the Hon'ble High Court has held that,

> *"5…it may be that the three suppliers from whom the assessee claimed to have purchased the steel did not own up to such sales. However, the vital question while considering whether the entire amount of purchases should be added back to the income of the assessee or only the profit element embedded therein was to ascertain whether the purchases themselves were completely bogus and non-existent or that the purchases were actually made but not from the parties from whom it was claimed to have been made and instead may have been purchased from grey market without proper billing or documentation."*

The Tribunal had estimated that 12.5% as a possible profit out of purchases made through non-genuine parties. The High Court upheld the estimation made by Tribunal but made a categorical noting that "*9…**the estimation of rate of profit return must necessarily vary with the nature of business and no uniform yardstick can be adopted***"

- ❖ The Hon'ble Courts have made different rates of estimation of bogus purchases based on the facts of each case as under:
  - ***Vijay Proteins v. CIT*** [2015] 58 taxmann.com 44 (Gujarat) – 25%
  - ***PCIT v. Jagdish H Patel*** [2017] 84 taxmann.com 259 (Gujarat) – 8%
  - ***PCIT v. Jakharia Fabric (P.) Ltd.*** [2020] 429 ITR 332 (Bombay) – 17.5%

- <u>Entire bogus purchases to be added to the total income:</u>

- ❖ The Hon'ble **Supreme Court** in the case of ***N. K. Proteins Ltd. v. DCIT*** [2017] 84 taxmann.com 195 (SC) has dismissed the SLP of the assessee against the decision of the Gujarat High Court [N.K. Industries Ltd. v. DCIT (2016) 72 taxmann.com 289 (Gujarat)] wherein 100% of bogus purchases were added to the total income of the assessee. The Hon'ble High Court had held that,

  "6…In the present case the Tribunal has categorically observed that the assessee had shown bogus purchases amounting to Rs. 2,92,93,288/- and taxing only 25% of these bogus claim goes against the principles of Sections 68 and 69C of the Income Tax Act. The entire purchases shown on the basis of fictitious invoices have been debited in the trading account since the transaction has been found to be bogus. The Tribunal having once come to a categorical finding that the amount of Rs. 2,92,93,288/- represented alleged purchases from bogus suppliers it was not incumbent on it to restrict the disallowance to only Rs. 73,23,322/-."

- ❖ Following the above decision of the Hon'ble Apex Court, the Mumbai Tribunal in case of ***Pratibha Pipes & Structurals Ltd v. DCIT*** (ITA No.3874/Mum/2015) has noted that the Assessing Officer has not made addition only on basis of report of Sales Tax department and the Assessing Officer has conducted all possible enquiries and directed assessee to file confirmations and to produce the parties for examination which was not done by the assessee. Further, no identification has been made of entry of goods in respect of the 22 parties. Accordingly, the Tribunal followed the decision of N. K. Proteins Ltd. *(supra)* and upheld 100% addition of bogus purchases under section 69C.

- ❖ However, even after taking into account the SLP dismissed in case of N. K. Proteins Ltd. (supra), the Bombay High Court in ***PCIT v. Mohommad Haji Adam & Co.*** *(ITA No. 1004 of 2016) has held that,*

  "8…the Tribunal was correct in coming to the conclusion that the purchases cannot be rejected without disturbing the sales in case of a trader. The Tribunal, therefore, correctly restricted the additions limited to the extent of bringing the G.P. rate on purchases at the same rate of other genuine purchases"

  The Hon'ble High Court has also noted that the decision of the Gujarat High Court in the case of N.K. Industries Ltd. *(supra)* cannot be applied without reference to the facts. Further in N.K. Industries Ltd. *(supra)*, the High Court has upheld estimation of gross profit on sales for other ground of appeal.

- Addition on basis of statement of third party without providing opportunity of cross-examination to assessee was invalid- ***Bhatia Diamonds Pvt. Ltd. v. ITO*** (ITA No. 2821/Del/2018)

- **Household expenses – Action of Assessing Officer to estimate amount of expenditure held to be valid**

  ❖ Amount of household expenditure declared at Rs. 7,59,723 appears to be on a lower side looking to the fact that over all family members in a joint family setup would be more. Thus, under the facts and circumstances of the case, addition of Rs. 3 lakhs over and above the sum of Rs. 7,59,723 as disclosed by the assessee would be sufficient and reasonable. - ***Ashok Kumar Gupta v. ITO***[2017] 86 taxmann.com 118 (Delhi)

  ❖ No withdrawal of household expenses made by assessee. The Tribunal held that there is no evidence on record to demonstrate that quantum of withdrawals by two sons and statement to the fact that their father did not contribute any household expenses. Thus, in these facts and circumstances of the case **assessee's explanation is not corroborated by any iota of evidence**. The Tribunal held that addition of Rs. 1 lac on account of household withdrawals is rightly made. - ***Radhey Shyam Agarwal v. ITO*** [2015] 61 taxmann.com 427 (Jaipur)

- **Disallowance of part expenditure**

  The assessee was in the best position to explain the expenditure incurred as per the books of account maintained but could give an explanation only with regard to a part of the expenditure and not the entire expenditure. Balance unexplained expenditure added to the income of the assessee - ***P. Ram Gopal Varma v. DCIT*** [2013] 40 taxmann.com 106 (Andhra Pradesh)

- **Expenditure not forming part of books of accounts also covered**

  Section 69C of the Act would take in its sweep, not only of the expenditure which was reflected in the books of accounts about also the other items of expenditure regarding which no proper explanation is forthcoming from the assessees, once they were discovered in the course of search and seizure. To give any other meaning to the Section would defeat the very purpose, for which it has been incorporated in the statute - ***Srinivasa Ferro Alloys Ltd. v. ACIT*** [2014] 51 taxmann.com 512 (Andhra Pradesh)

C. ***Section 69C is discretionary in nature***

- When the above two conditions are met, the legislature has given **discretion to the Assessing Officer** to deem the expenditure as income of the assessee. The section uses the word "may" and not "shall".

- The Hon'ble Supreme Court in case of ***CIT v. Smt. P.K. Noorjahan*** [1999] 237 ITR 570 (SC) in context of section 69 - Unexplained investments has held that,

  "3…a discretion has been conferred on the ITO under section 69 to treat the source of investment as the income of the assessee if the explanation offered by the assessee is not found satisfactory and the said discretion has to be exercised keeping in view the facts and circumstances of the particular case."

- Relying on the above decision of the Hon'ble Apex Court, in case of ***PCIT v. Rama Shankar Yadav*** [2017] 85 taxmann.com 173 (Allahabad), the High Court has held that,

  "10. At the same time, the use of the word "may" in the aforesaid provision makes the deeming provision discretionary and not mandatory. In other words, even if not explanation is offered or it is found to be unsatisfactory, it is not mandatory to treat such unexplained expenditure to be the income of the assessee…

  *17. The question raised above is answered in favor of the assessee and against the department and it is held that as the provision of **Section 69C of the Act is not mandatory in nature**, the Assessing Authority has full discretion either to add or not to add the unexplained expenditure in the income of the assessee based upon sound judicial principles…."*

5. RATE OF TAXATION

5.1. *Prior to AY 2013-14*:No specific provision in the statute providing a special rate of taxation. Therefore, the deemed income under section 69C was subject to tax rates as applicable to the category of person (slab rates in case of individuals, HUF etc.).

5.2. *AY 2013-14 to AY 2016-17*:Vide Finance Act, 2012, section 115BBEwith effect from AY 2013-14 and onwards to provide a **tax rate of 30%** plus applicable surcharge and cess on income chargeable under section 68/ 69/ 69A/ 69B/ 69C or 69D. The balance total income is chargeable to tax at normal rates. Further, **no deduction of any expenditure/allowance** shall be allowed to the assessee against such income.

5.3. *AY 2017-18 and onwards*: Vide Finance Act, 2016, section 115BBE was amended to provide that **no set off of any loss** shall be allowed against the deemed incomes as referred above. Further, by Taxation Law (Second Amendment) Act, 2016, **the rate of tax has been increased to 60%** plus applicable surcharge and cess from existing 30%.

Both the above amendments are with effect from 1 April 2017 i.e. AY 2017-18 and subsequent years.

6. PENALTY PROVISIONS

6.1. Section 271AAC of the Act provides that the Assessing Officer may levy a penalty of 10% of tax payable under section 115BEE.

6.2. As per Proviso to section 271AAC, no penalty shall be levied in respect of income referred to in section 69C to the extent such income has been included by the assessee in the return of income furnished under section 139 and the tax in accordance with the provisions of clause (i) of sub-section (1) of section 115BBE has been paid on or before the end of the relevant previous year. Therefore, if the unexplained expenditure is disclosed in the Return of Income and tax has been discharged by the assessee, no penalty is leviable.

6.3. Further, sub-section (2) of section 271AAC specifically provides that penalty under section 270A for under-reporting and misreporting of income shall not be imposed.

6.4. It is important to note that there is no amendment carried out in section 273B to include section 271AAC thereby implying that the penalty under this section may be leviable even if there is reasonable cause for failure.

7. PROSECUTION PROCEEDINGS

7.1. Section 276C of the Act provides for launch of prosecution proceedings if a person **willfully attempts** in any manner whatsoever to evade any (i) tax (ii) penalty (iii) interest chargeable/imposable under This Act or (iv) under reports his income, under this Act.

7.2. Explanation to section 276C states that a wilful attempt to evade any tax, penalty or interest chargeable or imposable under this Act or the payment thereof shall include a case of:

- false entry or statement in books of account/other documents; or
- omission of entry or statement in books of account/other documents; or
- any other circumstance which will have the effect of enabling the assessee to evade any tax, penalty or interest chargeable or imposable under this Act or the payment thereof.

Therefore, where an expenditure has been incurred by the assessee and the source is not found satisfactory by the Assessing Officer, it may fall within the ambit of "false entry/omission of entry" depending on the facts of the case.

7.3. In a recent case of ***Nayan Jayantilal Balu v. UOI and others*** (Criminal Writ Petition No. 2698 of 2021) before the Hon'ble Bombay High Court, addition of 12.5% of bogus purchases in case of the assessee was made by the AO and prosecution proceedings were launched under section 276C(1) of the Act. The Hon'ble Bombay High Court noted that the assessee failed to substantiate the claim of purchases and the additions were upheld by the Hon'ble Tribunal. The Hon'ble High Court held that,

> *"19......we are satisfied that, prima facie, the ingredients of the offences under Section 276C(1) of the said Act are satisfied..."*

7.4. The imprisonment term ranges from 3 months to 7 years and with fine – *Section 276C*

For every second and subsequent offence, the imprisonment term ranges from 6 months to 7 years and with fine – *Section 278A*

7.5. Section 279 of the Act empowers the Pr. CCIT/ CCIT/ Pr. DG/ DG to compound the offences under Chapter XXII of the Act.

The quantum of taxation of unexplained expenditure, penalty and prosecution proceedings and the intricacies therein is discussed in subsequent topic in detail.

8. CONCLUDING THOUGHTS

The taxation of unexplained expenditure has been a vexed issue over the years and is largely dependent on the facts of each case. As seen above, there is no end to the controversies in addition of bogus purchases even after touching the doors of the Hon'ble Apex Court. Therefore, it is of prime importance to maintain robust documentation to prove the genuineness of expenditure incurred so as to avoid facing the harsh consequences there from.

TAXATION OF UNEXPLAINED INCOMES

CA Namrata Dedhia
Email : namrata@shahdedhia.com

Background:

Under the Income-tax Act, 1961, sections 68 and 69 to 69D bring cash credits and unexplained investments, money, expenditure, etc. within the tax net as undisclosed incomes. Having computed the income of any taxpayer under the five heads of income and after including incomes of any other persons, which are liable to be taxed as the taxpayer's incomes, any items that have remained undisclosed or unexplained - such as cash credits in the books of accounts, investments or expenditure or borrowing or repayment of hundi, other than by way of account payee cheque – are liable to be included in the total income of the assessee.

Taxation of Unexplained Incomes:

The manner of taxation of these unexplained incomes is dealt with in two parts – the charge is created in the aforesaid charging sections 68, 69 to 69D and the taxability of the said income is laid down in section 115BBE.

The charging sections, as discussed in detail in the other articles in this newsletter, lay down the conditions when a certain item shall be added to the income of the taxpayer, i.e., when the taxpayer is not able to offer any explanation regarding the nature and source of the cash credits or investments or money, etc. or the explanation offered is not satisfactory in the opinion of the Assessing Officer. Further, these sections also provide the point of time at which such items are included in the income of the taxpayer, i.e., in case of money, bullion, jewellery, etc., the year in which such assets are found, and in other cases, in the year in which the transaction is undertaken.

As regards the machinery section, no specific section existed in respect of taxability of unexplained incomes prior to AY 2013-14. As a consequence, even though an addition was made to the income of a taxpayer on account of unexplained income, the same was taxed as per the applicable slab rates and did not result in any harsh tax liability on the taxpayer. In fact, in case of taxpayers, whose total income did not exceed the basic exemption limit, the addition of explained incomes, had no adverse tax effect. Penalty indeed was leviable, but the same was also discretionary in nature.

In order to deter taxpayers undertaking such transactions without disclosing the same in the return of income, section 115BBE was introduced by the Finance Act, 2012,with effect from AY 2013-14, providing for a special rate of tax of 30% in case of deemed incomes under the aforesaid sections, without allowing for any deduction in respect of any expenditure or allowance to the taxpayer under any provision of the Act. Tax under section 115BBE is further liable to be increased by the applicable surcharge, based on the income slab of the taxpayer and cess.

Section 115BBE has very wide applicability in the sense that–

a) it applies to taxpayers of their legal or residential status, and

b) there is no threshold limit for application of section 115BBE, thereby making it possible to invoke the provisions for an immaterial amount of income, so long as it is unexplained income chargeable under the aforesaid sections.

Finance Act 2016 further amended this section with effect from AY 2017-18 to provide that in addition to the restriction on claiming deduction in respect of any expenditure or allowance, even set off of loss under any provision of the Act shall not be allowed to a taxpayer in respect of the aforesaid unexplained incomes. Thus, if a taxpayer has any loss in respect of the same year under any head of income, or brought forward loss in respect of earlier years, the same cannot be set off against the unexplained income, defeating the purpose of section 115BBE to act as a deterrent for the taxpayers.

This amendment also attempted to address the litigation around whether losses, and more specifically brought forward losses, can be set off against unexplained incomes since the same were not categorized under any head of income under section 14. However, it was made applicable from AY 2017-18 and thus, applies prospectively and would not apply in respect of AY 2016-17 or prior. This view has been upheld in a slew of judgements by various courts and tribunals including the Honourable Rajasthan High Court in the case of *PCIT v. Aacharan Enterprises (P.) Ltd. [2020] 273 Taxman 85 (Rajasthan)* and the Honourable Madras High Court in the case of *Shree Karthik Papers Ltd. V. DCIT [2020] 273 Taxman 546 (Madras)*.

Upon announcement of demonetization of currency on 8th November 2016, under the extant provisions of law, it was possible for taxpayers to suo moto declare the cash deposited into the bank accounts as unexplained income in the return of income and pay a tax liability of 30% (plus applicable surcharge and cess) on the same without any levy of penalty. For taxpayers having undisclosed incomes, this would have been a simple way to declare all such undisclosed income by paying tax at a rate of 30%.

Thus, to prevent the taxpayers from using this window to declare all previously undisclosed income, the provisions of section 115BBE were amended with effect from 1.4.2017, i.e. AY 2017-18 vide Taxation Laws (Second Amendment) Act, 2016 to provide as under –

a) The provisions of section 115BBE shall apply to unexplained incomes under sections 68, 69 to 69D whether the same were reflected by the taxpayer in the return of income filed under section 139, or whether the same was not so disclosed in the return of income, but was determined by the Assessing Officer, and

b) The said unexplained incomes shall be liable to be taxed at a higher rate of 60%.

Although this amendment was introduced in the back drop of the demonetization exercise, this higher rate of 60% was, however, not linked to cash deposits made consequent to demonetization alone. It was rather made applicable for any unexplained incomes includible in the total income under sections 68 or 69 to 69D.

Further, the Taxation Laws (Second Amendment) Act, 2016 also amended the provisions of Finance Act, 2016 to provide that in case of incomes taxable under section 115BBE, the applicable surcharge would be 25% of tax, i.e. 15% of the income. Thus, the effective rate of tax under section 115BBE for AY 2017-18 and AY 2018-19 became 60% tax + 15% surcharge + 2.25% cess, i.e., 77.25% of the unexplained income (as aggregate rate of cess was 3% for these assessment years). For AY 2019-20 onwards, the rate of cess is increased to 4% and accordingly, the effective rate of tax under section 115BBE now stands at 78% of the unexplained income.

The impact of the aforesaid amendments is not only that unexplained incomes are taxable at a much higher rate than the normal incomes without deduction of any expenditure, allowance or set off of loss, but also that where the taxpayer has suo moto offered to tax any ad hoc income in the return of income, for which he is unable to provide any satisfactory explanation, the same can also be considered as unexplained income and attract the higher rate of tax under section 115BBE.

Penalty Provisions:

Taxation Laws (Second Amendment) Act, 2016 also introduced new penalty section 271AAC for levy of penalty at the rate of 10% of the tax payable on unexplained incomes liable to be taxed as per section 115BBE. This penalty is in addition to the tax liability under section 115BBE. The first proviso to section 271AAC(1), however, provides that the said penalty shall not be levied if such income has been included by the taxpayer in his return of income furnished under section 139 and the tax computed as per section 115BBE has been paid within the previous year, i.e., on or before 31st March of the previous year.

In other words, penalty under section 271AAC can be levied by the Assessing Officer if –

a) The said unexplained income is not disclosed by the taxpayer in the return of income, but is instead determined by the Assessing Officer during the course of any proceedings, or

b) The said unexplained income is disclosed by the taxpayer in the return of income, but tax on the same has not been paid on or before the end of the previous year.

It is worth noting that the requirement for payment of tax on or before the end of the previous year as per section 271AAC is not correlated with the provisions for advance tax. This would imply that even where the taxpayer is suo moto offering any unexplained income to tax in the return of income, he would be required to pay the entire tax on the same, i.e. 60% tax + 15% surcharge + 3% cess as advance tax, failing which he could be liable to penalty under section 271AAC. In other words, payment of 90% of the tax liability as advance tax as per the usual norms, would save the assessee from interest on delayed payment of tax under section 234B, but would not help him escape the penalty provisions.

Section 271AAC also provides that penalty under section 270A for under-reporting or mis-reporting of income shall not be levied on such unexplained income.

Issues:

Certain issues that arise from the provisions of section 115BBE and section 271AAC as under –

<u>Chapter VI-A Deductions -</u>

Section 115BBE prohibits claim of deduction of any expenditure or allowance or set off of any loss against the unexplained incomes. However, deductions under Chapter VI-A are not necessarily deductions in respect of "any expenditure or allowance" and thus, it may be possible to claim such deductions against the unexplained incomes.

<u>Unexplained income offered suo moto -</u>

Clause (a) of sub-section (1) of section 115BBE refers to a situation where the unexplained incomes under sections 68, 69 to 69D is suo moto offered to tax by the taxpayer in the return of income filed under section 139. While this clause has no relevance for the rate of tax applicable under section 115BBE, it becomes relevant for the applicability of the penalty section 271AAC, wherein as discussed above, it is provided that penalty would not be applicable in such cases if the applicable tax is paid on or before the end of the previous year.

As section 115BBE(1)(a) makes a reference to section 139, it would thereby include belated return under section 139(4), revised return under section 139(5), or even an updated return filed under section 139(8A). Further, as a return filed under section 153A is treated to be a return filed under section 139, a view can be taken, that the same would be covered by the first limb of section 115BBE(1). A return filed in response to a notice issued under section 148, however, would not enjoy the same benefit and it is likely to be considered under the second limb and thus, open to penalty provisions.

Invoking of Section 68 –

It is observed that the Assessing Officers often invoke section 68 in the assessment orders to tax incomes, which are otherwise dealt with in other provision of the Act. For instance, where investment in received by a private company, not only is the valuation of the same examined under section 56(2)(viib), but where the company is unable to furnish income tax returns and bank statements of investors, the same is also considered as unexplained cash credit under section 68, despite the powers of the Assessing Officer to call for information under section 133(6). Such situations can be very precarious, as the higher rate of tax under section 115BBE acts as an incentive for the Assessing Officers to apply the provisions of section 68, even when the same may not be relevant or where specific provisions exist in the Act.

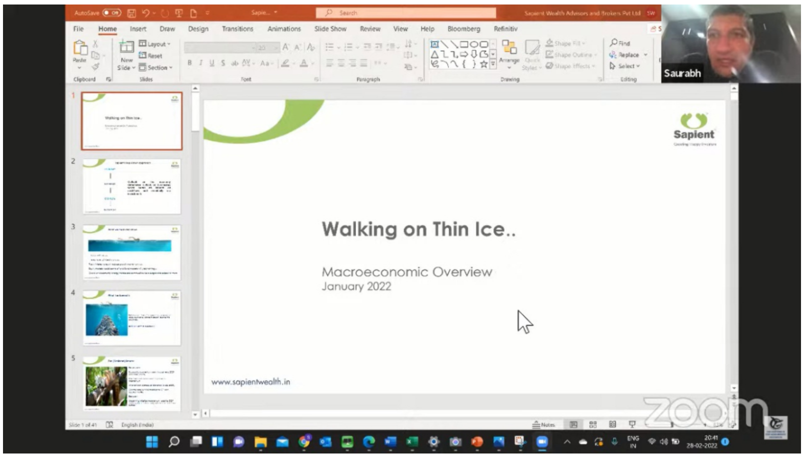
Further, in light of the amendment to section 68 by Finance Act 2022, which places the onus of proof to demonstrate the "source of source" on the taxpayer, despite sufficient powers available to the Assessing Officers to investigate such "source of source", the scope of this section and thereby the higher rate of tax under section 115BBE becomes far too wide.

Conclusion:

Time and again, attempts have been made by the authorities to deter taxpayers from evading taxes, first by legislating provisions for chargeability of unexplained incomes, cash credits, money, investments, etc., thereafter by taxing the same at the maximum marginal rate under section 115BBE and further by increasing the tax rate to a whopping 60% plus a higher surcharge, cess and penalty. This, coupled with recent amendments in Finance Act 2022 to section 68, nearly incentivizes the Assessing Officers to blindly apply these provisions. Where such a high rate of tax is sought to be levied, it would only be rational to cast some burden of discharging the onus of proof on the Assessing Officers, failing which, the taxpayers are left to the subjectivity of the "satisfaction" of the Assessing Officer. In the bid to curb evasion of taxes and generation of black money, such provisions can potentially cause more than just discomfort to a much wider mass of honest and small taxpayers and the same needs to be addressed urgently.

Events In Retrospect

Day & Date	Committee	Program Name	Speaker	Attendance / Views
28th February, 2022	Capital market Committee	Impact of Macro Economic Factors on Indian Economy and Commodity	Mr. Saurabh Bhatia, Head – Macro Strategy & Fixed Income at Sapient Wealth Advisors	459 *



EVENTS IN RETROSPECT

Day & Date	Committee	Program Name	Speaker	Attendance / Views
9th April, 2022	Capital Market Committee	Industrial Visit to Filatex, Dahej Unit	N.A.	38