BENEFIT OF TELESCOPING

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'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

<u>Addition under section 68 and Telescoping</u>

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.