The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)

Referencer on

Section 68 w.r.t. Capital Transactions, Section 148 w.r.t. Share Trading & Long Term Capital Gain, Section 14A & Stay Petition

Eastern India Regional Council
The Institute of Chartered Accountants of India

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ABOUT THE ICAI

The Institute of Chartered Accountants of India is a statutory body established by an Act of Parliament viz., The Chartered Accountants Act, 1949 in the year 1949 for regulating the profession of Chartered Accountancy in the country. The Institute, which functions under the administrative control of Ministry of Corporate Affairs, Government of India, has five Regional Councils at Mumbai, Chennai, Kanpur, Kolkata and New Delhi. It presently has 153 Branches covering the length and breadth of the country, 22 Chapters outside India and an overseas office in Dubai.

Founded 66 years ago with just seventeen hundred members, the Institute has grown to cross mark of 2,46,000 members and 9,35,000 students as of now. A significant majority of our membership is in practice and a good deal of specialisation in traditional areas of direct/indirect taxes and in emergent specialism's inter-alia, in financial services, information technology, insurance sector, joint ventures, mutual funds, exchange risk management, risk and assurance service environment/energy/quality audits, investment counseling, corporate structuring and foreign collaborations. The other half was/is in employment, many occupying senior positions such as CMDs in Banks/Financial Institutions, CEOs in leading and reputed public/private sector companies etc.

One of the important elements of the developmental role of the Institute is to make contributions to Government authorities and Regulations viz., the Ministry of Corporate Affairs, Trade Policy Division of the Ministry of Commerce, CBDT, RBI, IRDA, C&AG, SEBI etc. to name a few, on relevant matters of importance to the economy and profession.

On International front, the Institute, a permanent member of International and Regional Accounting bodies, like International Federation of Accountants(IFAC), International Accounting Standards Board(IASB), Confederation of Asian and Pacific Accountants(CAPA) and South Asian Federation of Accountants(SAFA) has made its presence felt through its effective and sustained contribution Professional bodies like American Institute of Certified Public Accountants(AICPA) in U.S.A. The Institute of Chartered Accountants in England and Wales(ICAEW) in U.K. and a host of similar bodies in many other countries have signed MOUs with our Institute for professional collaboration in areas such as education, examination, training etc. and on issues confronting the accounting profession worldwide.

The Institute, being a statutory body, is administered by a Council which is the highest policy making body of the chartered accountancy profession. The Council is comprised of 40 members of whom 32 are elected from among its members spread all over the country. The remaining eight members are nominated by the Central Government representing such authorities as the Comptroller and Auditor General of India, Ministry of Finance, Ministry of Corporate Affairs and persons of eminence from the fields of law, banking, economic, business, finance, industry, management, public affairs etc.

ABOUT EIRC

In 1952, Eastern India Regional Council (EIRC of ICAI) was constituted with its jurisdiction on West Bengal, Orissa, Assam, Tripura, Sikkim, Arunachal Pradesh, Mehalaya, Nagaland, Manipur, Mizoram and the Union Territory of Andaman & Nicobar Islands. The founder Chairman was Mr. Molay Deb and the office of EIRC was located in the 2nd Floor of 7, Hastings Street(Now renamed as Kiron Shankar Roy Road).

On 10th December, 1975, the foundation stone of the present EIRC Building at 7, Russell Street (Now renamed as Anandilal Poddar Sarani) was led by the then Chief Justice, Calcutta High Court, Hon'ble Justice Shankar Prasad Mitra. On 14th April, 1977, the building was inaugurated by the then Hon'ble Governor of West Bengal, His Excellency Shri A.L. Dias.

On 17th January, 2014, the Second State of Art Building at 382/A, Prantik Pally, Rajdanga, Kasba, Kolkata-700107 has been inaugurated and the same is in operation to cater its dedicated service to its more than 23,005 Members and 83,690 Students.

EIRC has 11 Branches, 18 Study Circles, 5 Study Circles for Members in Industry, 5 CPE Chapters and 8 Study Groups.

EIRC has the privilege and pride in presenting 10 Presidents to ICAI and each one of them has enriched and empowered the profession through their visionary leadership and innovative dynamism.

The cherished dream of EIRC is to kindle the spark within the fraternity and to make the members world class professionals as well as good human beings – to contribute as an active partner in the nation building exercise.

CHAIRMAN'S MESSAGE

Dear Professional Colleagues,

The success of all the Referencers launched by us recently has truly been inspiring and a motivating factor for us. Since my takeover as Chairman, EIRC, I have a dream of giving my best to all the Members and Students and this was just a small step in that direction. I really fall short of words when it comes to expressing my happiness for the response received from all the Members. It will be our constant endeavour to serve the fraternity and so we are here with yet another **Referencer on Sec 68 w.r.t. Capital Transactions, Section 148 w.r.t. Share Trading & Long Term Capital Gain, Section 14A & Stay Petition** which would be released on **18th May 2016**.

It is our endeavour to empower Members with information which would be exhaustive and at the same time handy. With various, multifarious sections being covered, the Referencer would provide a good insight to readers on the provisions explained. The Referencer has been compiled lucidly and vividly not only to simply the professional work of our esteemed Members but also to help them meet the expectations of their clients. Eminent speakers have been invited to address the seminar who would further add to your knowledge on the subject.

I am indeed beholden to all my Regional and Central Council colleagues for their support in this initiative. I would like to make special mention of CA Manish Goyal, Chairman, Direct Taxes Committee of EIRC & CA Nitesh Kumar More, Chairman, Research Committee of EIRC for conceptualising and bringing out a Referencer on this subject. I would also like to acknowledge the tremendous encouragement provided by all the readers in bringing out such useful Referencers by us.

Let's touch base…today, tomorrow and forever!!!

Date : 18th May 2016
Place : Kolkata

CA Anirban Datta
Chairman, EIRC

CHAIRMAN, DIRECT TAXES COMMITTEE & CHAIRMAN, RESEARCH COMMITTEE'S MESSAGE

Dear Professional Colleagues,

We are pleased to present before you **Referencer on Sec 68 w.r.t. Capital Transactions, Section 148 w.r.t. Share Trading & Long Term Capital Gain, Section 14A & Stay Petition** for the benefit of all our Members.

Study of tax laws is a continuous pursuit. There is always a scope for further enhancement of knowledge on the subject. Keeping this in mind we have brought out this Referencer to address the queries of our Members on some of the most important topics. We have tried to give the basic provisions on the various topics as briefly as possible for greater readability and understanding of all. We are sure that all the readers would be immensely benefited by this Referencer.

We take this opportunity to place on record our sincere gratitude to CA Anirban Datta, Chairman, EIRC for his encouragement and motivation in bringing out this Referencer. We are also thankful to our other Central Council and Regional Council Members for their contribution for the same. We would like to acknowledge the efforts of various contributors who have patiently put up their time in preparation of a comprehensive material on the subject. We are also thankful to Mr Subhas Agarwal, Advocate for vetting and editing the Referencer, apart from his contribution.

With these few words, we present this book to the readers with the fervent hope that they will find it useful. Suggestions are most welcome and the same can be sent to eircreferencer@gmail.com.

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Vice Chairman, EIRC &
Chairman, Direct Taxes Committee,
EIRC of ICAI

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EIRC of ICAI

Date : 18th May 2016
Place : Kolkata

ACKNOWLEDGEMENT

We are thankful to all the tireless efforts in earnestly contributing for the **Referencer on Sec 68 w.r.t. Capital Transactions, Section 148 w.r.t. Share Trading & Long Term Capital Gain, Section 14A & Stay Petition**. Without their kindest support this would not have been a success.

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SECTION 68 - SHARE CAPITAL OR SHARE APPLICATION MONEY

1. Introduction:

a) Justice Oliver Wendell Holmes once said, "*Taxes are what we pay for civilized society including the chance to insure*". The same feeling was echoed by President Roosevelt in a speech given on a topic of Tax Evasion when he said "*taxes are what we pay for civilized society, too many individuals however want the civilization at a discount*". Another American judge, Felix Frankfurter similarly said "*I like to pay taxes. With them I buy civilization*". Thus, taxes are considered as our dues to the State for ensuring us to live in a civilized society that is democratic, provides opportunities and creates huge infrastructures such as roads, railways, highways, education system, health system, power grids, national security, police, economy, etc. Our taxes maintain them.

b) *Salomon v. Salomon & Co. (1896), [1897] A.C. 22 (H.L.)* is a foundational decision of the House of Lords in the area of company law. The effect of the Lords' unanimous ruling was to firmly uphold the concept of a corporation as an independent legal entity, as set out in the Companies Act 1862.

c) Many a times, the Assessing Officer or the higher authority doubts the genuineness of the amount credited to share capital and/or premium received on issue of shares, particularly in case of closely held companies.

The issue at the core of this dispute is issue of shares by several unlisted companies at significantly high premium which are not concomitant with the fair value of business, including future prospects. Such instances have been alleged as a subterfuge to infuse *'black unaccounted money*' by many such companies into the system through share capital.

Though these transactions pertain to period prior to April 1, 2013, provisions of Section 68 of the Income-tax Act are sought to be invoked to bring the excessive premium to tax. The date April 1, 2013 is relevant as law has been amended to subject such excessive premium to tax in the hands of recipient under Section 56(2)(viib). However, tax department seems to be of the view that the aforesaid amendment does not preclude them from invoking Section 68 for transactions prior to April 1, 2013.

Section 68 of the Income-tax Act is one of the most powerful yet debated provision of the Income-tax Act. This provision has given plethora of judgments, often conflicting, both in favour of Revenue and the assessee.

2. Section 68 of the Income-tax Act reads as under:

1. Cash credits.

68. Where any sum is found credited in the book 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;

The following provisos shall be inserted in Section 68 by the Finance Act, 2012, w.e.f. 1-4-2013

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.*

3. *The Proviso- amendment*

Finance Act, 2012 inserts two provisos to Section 68, with effect from 1-4-2013 (assessment year 2013-14). First proviso to enlarge the onus of a closely held company and provides that if a closely held company receives any share application money or share capital or share premium or the like, it should also establish the source of source (that is, the resident from whom such money is received). Second proviso provides that the first proviso will not apply if the receipt of sum (representing share application money or share capital or share premium etc.) is from a VCC or VCF [referred in Section 10(23FB)].

Objective of the amendment–As explained in the Memorandum:

"Certain judicial pronouncements have created doubts about the onus of proof and the requirements of this section, particularly, in cases where the sum which is credited as share capital, share premium etc.

Judicial pronouncements, while recognizing that the pernicious practice of conversion of unaccounted money through masquerade of investment in the share capital of a company needs to be prevented, have advised a balance to be maintained regarding onus of proof to be placed on the company. The Courts have drawn a distinction and emphasized that in case of private placement of shares the legal regime should be different from that which is followed in case of a company seeking share capital from the public at large.

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".

It is noteworthy that the provisions of Section 68 has been amended w.e.f. April 1, 2013 to provide that in addition to the recipient, the person contributing to the share capital of a private or an unlisted company also has to explain the nature and source of funds. Obviously the amendments was brought in to reverse the law laid down by Supreme Court in case of Lovely Exports that if the recipient explains the nature and source of funds, in the absence of confirmation from the contributor of funds, no addition can be made in the hands of the recipient.

As this amendment has been introduced along with introduction of Section 56(2)(viib) which is applicable w.e.f. April 1, 2013, one view could be that the amendment to Section 68 is also prospective in operation.

The other view could be that as Section 68 used to be invoked in the past to question share capital transactions, the amendment is only clarificatory in nature and, therefore, retrospective in operation. It would be only time before the matter lands in a Court of law to decide if the amendment is prospective or retrospective in nature.

One way or the other, the amendment does not take away the fact that Section 68 can be invoked only in situation where nature and source of funds remain unexplained by the recipient and the contributor. Though the intent behind introduction of both the sections is to subject unaccounted money to tax, these sections operate in different spheres and are invoked in different situations. Neither both the sections can be applied in a given case nor if one fails to be applied, the other can be conveniently applied to bring such excessive premium to tax. It is a settled principle in law that where there is a specific provision in law the same would prevail over a general provision.

To reiterate, Section 68 can be invoked in a situation where in nature and source of funds remain unexplained by the recipient and the contributor. If the nature and source of funds stands explained, tax department could then have recourse under Section 56(2)(viib) only in situations where difference in technical aspect of valuation exist. However, the converse may not be true i.e. if Section 56(2)(viib) is invoked to tax the difference in technical aspect of valuation, the test of nature and source of funds stand automatically satisfied. The rigours of Section 68 should stop with the investigation into nature and source of funds and not extend to cater to the technical aspect of valuation dealt specifically under section 56(2)(viib) as the Legislature may not have intended to provide two sections i.e. Section 56(2)(viib) and Section 68 to be used interchangeably.

Thus in case of private limited companies higher onus is cast upon them to explain even source of source of the share application money/ share premium etc.

4. Let us understand what was happening and why such amendment: Company XYZ Pvt. Ltd. used to adopt the following *modus operandi* to convert black money into white money:

- 100 slum dwellers were contacted and their PAN cards were made and their bank accounts were opened. In the previous year 31-03-2011, Rs. 2,00,000 each cash was deposited in their bank accounts and cheque of Rs.2,00,000 was taken from them in the name of the company XYZ Pvt. Ltd. They were made to sign share application form that they are applying for 10,000 shares of 10 each face value at a premium of 10. They were also made to sign blank transfer deeds for share transfer. Each slum dweller's return was filed showing income of Rs. 2,00,000/- for previous year 31-03-2013 and tax thereon is NIL. For this process each slum dweller was paid Rs.2,000 in cash i.e. unaccounted money.

- In the above process company XYZ Pvt. Ltd. has deposited unaccounted cash of Rs.2,00,000 x 100 = Rs.2 crores. In the slum dwellers' bank account and received cheques of Rs.2 crores as share application money in the company XYZ Pvt. Ltd.

- The Fair Market Value of shares of company XYZ Pvt. Ltd. is Rs. 20 per share.

- The company XYZ Pvt. Ltd. either shows Rs.2 crores as Share Application Money or allots 10,000 shares of Rs.10 each at a premium of Rs.10 to the slum dwellers however, physical custody of these shares is not given to the slum dwellers and company retains the same. The company is safeguarded by the blank share transfer deeds.

- Now the Assessing Officer takes the case of the company in the scrutiny assessment u/s. 143(3) for the above mentioned previous year. The Assessing Officer asks the explanation from the company for the nature and source of sum of Rs. 2 crores credited by the company in its books as share application money or asks share capital introduced and premium thereon. The A.O. asks for;

  (i) bank pass books of these 100 slum dwellers.

  (ii) personal appearance of these 100 slum dwellers

  The company simply produces to the A.O.;

  (i) Name and address of slum dweller

  (ii) PAN of slum dweller

  (iii) ITR of slum dweller.

  The company does not produce the pass books of these slum dwellers and does not produce them personally before Assessing Officer to investigate the case and finds that cash of Rs. 2,00,000 was deposited in bank account of each slum dweller and finds that slum dweller has no financial standing. Slum dweller is not able to offer explanation about the source of Rs.2,00,000 or the explanations offered by him are found to be unsatisfactory by Assessing Officer. The Assessing Officer invokes section 68 and adds Rs.2 crores to the income of the company as unexplained cash credits because the persons from whom share application money came were not able to prove the source of money in their hands. Such additions u/s.68 so made in the hands of the company was not being sustained in Appeals because Hon'ble Supreme Court *Lovely Exports (P) Ltd. [(2009) 319 ITR 0005]*, has held as under:

  "If the share application money is received by the assessee-company from alleged bogus shareholders, whose names are given to the Assessing Officer, then the department is free to proceed to reopen their individual assessments in accordance with law but this amount of share money cannot be regarded as undisclosed income under section 68 of the assessee company.

  The Supreme Court held that ***there is no onus on the company to prove the source of money in the hands of shareholder or the persons making payment of share application money.***

  If company identifies the persons from whom money has been received, then section 68 cannot be involved in the hands of company."

- Thus, by virtue of above Supreme Court Judgment, no income was possible to be added in hands of company under section 68.

- In hands of slum dwellers, the Assessing Officer applies section 68 as Rs.2,00,000 credited in bank account is unexplained. The slum dweller is not able to offer any explanation about the source of Rs.2,00,000 or the explanation offered by him are found to be unsatisfactory. But since the slum dwellers had no other source of income, the only income assessed was Rs.2 lakhs under section 68. Considering the slab limit of Rs.2,00,000 no tax/interest/penalty could be levied on the above slum dwellers.

- Thus, Rs.2 crores black money thus was possible to be converted into white money by the company with no tax implication.

5. However, it is important to note the recent decision of Hon'ble High Court of Delhi in case of ***CIT vs. Nova Promoters & Finlease (P) Ltd.[(2012) 342 ITR 169,*** *Delhi HC]* wherein Hon'ble Justice Mr. R.V. Easwar speaking for the bench held "*there is ample authority for the position that where an assessee fails to prove satisfactorily the source and nature of certain amount of cash received during the accounting year, the Income tax Officer is entitled to draw the inference that the receipt are of an assessable nature. Section 68 recognizes the aforesaid legal position. The view taken by the Tribunal on the duty cast on the Assessing Officer by section 68 is contrary to the law laid down by the Supreme Court in the judgment cited above. Even if one were to hold, albeit erroneously and without being aware of the legal position adumbrated above, that the Assessing Officer is bound to show that the source of the unaccounted monies was from the coffers of the assessee, we are inclined that in the facts of the present case such proof has been brought out by the Assessing Officer. The statements of Mukesh Gupta and Rajan Jassal, the entry provides, explaining their modus operandi to help assessee's having unaccounted monies convert the same into accounted monies affords sufficient material on the basis of which the Assessing Officer can be said to have discharged the duty. The statements refer to the practice of taking cash and issuing cheques in the guise of subscription to share capital, for a consideration in the form of commission. As already pointed out, names of several companies which figured in the statements given by the above persons to the investigation wring also, figured as share-applicants subscribing to the shares of the assessee-company.*

These constitute materials upon which one could reasonably come to the conclusion that the monies emanated from the coffers of the assessee-company. The Tribunal, apart from adopting an erroneous legal approach, also failed to keep in view the material that was relied upon by the Assessing Officer. The CIT (Appeals) also fell into the same error. If such material had been kept in view, the Tribunal could not have failed to draw the appropriate inference."

6. Finance Act, 2012 nullifies the above tax planning. Proviso to section 68 has been added by Finance Act, 2012 which nullifies the effect of the Supreme Court judgment in *Lovely Exports (P) Ltd.* Thus, as per the Proviso inserted by Finance Act, 2012:

If in case of a closely held company any sum is found credited in its books of account as share application money, share capital, share premium or any such amount by whatever name called (Rs.2 crores in above example in case of XYZ Pvt. Ltd.) the explanation given by these residents (slum dwellers in above example) to the Assessing Officer is found to be unsatisfactory by the Assessing Officer. Then, it shall be deemed that the explanation offered by the assessee company about the sum so credited (Rs.2 crores in our example) is not satisfactory and consequently Rs.2 crores shall be deemed to be income of the company as unexplained credit under section 68. The crux of amendment is that the closely held company receiving share application money/share capital/share premium/any such amount has to prove the source of funds in the hands of shareholder/person giving the share application money/share capital/share premium/any such amount.

The Finance Act, 2012 has placed onus of proof on the closely held company receiving the share application money/share capital/ share premium/any such amount has to prove that such money which is invested in the company belongs to the person who has given the money to the company. Otherwise, the money so received shall be taxable in hands of company as unexplained cash credit under section 68.

7. Further section 115BBE has been introduced by Finance Act, 2012 which provides as under:

a. Where the total income of an assessee includes any income referred to in section 68, section 69, section 69A, section 69B, section 69C or section 69D, the income-tax payable shall be the aggregate of—

The amount of income-tax calculated on income referred to in section 68, section 69, section 69A, section 69B, section 69C or section 69D, **at the rate of thirty per cent**; and **Normal tax rate on the balance income.**

b. Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of this Act in computing his income referred to in clause (a) of sub-section (1).

- The effect of section 115BBE will be that these 100 slum dwellers who have unexplained cash credit of Rs.2,00,000 will not get slab benefit of Rs. 2,00,000 and Rs. 200,000 shall be taxable at a flat rate of 30.90%. Therefore, each slum dweller will have to pay tax of Rs.61,800.

- Section 115BBE hits these slum dwellers who were a party to the transaction of converting black money into white money.

No expenditure shall be allowed from the income so deemed under section 68 and deductions under Chapter VI-A shall also be not allowed from such deemed income.

The proviso to section 68 added by Finance Act, 2012 and section 115BBE also nullifies the following tax planning:

Cash of Rs.2,00,000 was deposited in account of a non-earning member of family or servant/driver in the house and it was shown as income from tuitions / boutique. Income tax returns were filed for these non-earning members/servant/driver showing income of Rs.2,00,000 and Nil tax thereon. Then, this Rs.2,00,000 was taken as a loan into the business from these people. Now, the Assessing Officer has the power to ask the source of Rs.2,00,000 from the non earning members/servant/driver being credited to their bank account. Assessing Officer will ask for name and addresses of student's to whom tuitions were given and names and addresses of persons to whom boutique services provided. If no explanation is given or explanation is found to be unsatisfactory by Assessing Officer, then, Rs.2,00,000 will be added as income from unexplained credit under section 68 in hands of non-earning member / driver / servant. As per section 115BBE this income will be taxed @ 30.90% without the slab of Rs. 2,00,000 i.e. tax of Rs. 61,800. Thus, the practice of converting black money into white money has been attacked.

Note:

Proviso to section 68 introduced by Finance Act, 2012, is not applicable to money received from Venture Capital Company and Venture Capital Fund since they are regulated by SEBI.

8. The share premium is to be decided by the Board of Directors and there is no prohibition under the Companies Act so far as the amount of premium is concerned. It is further stated that the reasons recorded are against the law as it has been held by the Hon'ble Supreme Court in the case of **CIT v. Allahabad Bank Ltd. [1969] 73 ITR 745** that the share premium received on the issue of shares has to be included in the paid up capital irrespective of whether the share premium has been maintained in a separate account apart from the reserve.

Support is also derived from the decision of the Hon'ble Supreme Court in the case of ***CIT v. Standard Vacuum Oil Co. [1966] 59 ITR 685*** wherein it has been held that premium realized from the issue of its shares represents reserves not allowed in computing the profits of the company for the purpose of Indian Income-tax Act, 1922. Reliance can also be placed upon the decision of Delhi High Court in the case of ***Addl. CIT v. Om Oils & Oil Seeds Exchange Ltd. [1985] 152 ITR 552*** **and** ***CIT v. Krishnaram Baldeo Bank (P) Ltd. [1983] 144 ITR 600(MP)*****.**

Vide *INSTRUCTION NO. 2/2015 [F.NO.500/15/2014-APA-I*], *dated 29-1-2015,* the CBDT clarified that in view of the decision of the High Court of Bombay in the case of *Vodafone India Services Pvt. Ltd*. for A.Y. 2009-10 (WP No.871/2014), wherein the Court has held, inter-alia, that the premium on share issue was on account of a capital account transaction and does not give rise to income, hence share premium is not liable to transfer pricing adjustment.

In the said instruction, the Board has further stated that it has accepted the decision of the High Court of Bombay in the above mentioned Writ Petition. In view of the acceptance of the above judgment, the Board directed that the ratio *decidendi* of the judgment must be adhered to by the field officers in all cases where this issue is involved and has asked the senior officers to bring the instruction to the notice of the ITAT, DRPs and CIT (Appeals).

9. With effect from Assessment Y 2013-14, it is provided u/s 56(2)(viib) that where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to tax under the head "Income From Other Sources".

10. In a recent case of ***N. Tarika Property Invest. (P.) Ltd. v. Commissioner of Income-tax 51 taxmann.com 387 (SC)*****,** the Supreme Court has held that where false evidence had been adduced by assessee to give colour of genuineness to bogus entries through bank accounts and deposits which were mostly by cash, Assessing Officer was justified in making addition under section 68.

Facts of the case:

On the basis of some information, the assessee was identified as one of beneficiaries who had received bogus entries and accordingly a notice under section 148 was issued to the assessee to furnish information in respect of persons who had been allotted shares. The assessee filed confirmation from the respective persons who had subscribed to the share capital.

The Assessing Officer noticed that the extracts of bank accounts of concerned parties submitted by the assessee during the original assessment proceedings had been fabricated and he requisitioned for the bank statements from the banks which established that immediately before the issuance of cheques for the purpose of making pay order or demand draft, there was a deposit of cash. Deposits were mostly by cash or transfer entries from the same bank of the entry providers.

The Assessing Officer held that the said companies had no creditworthiness, financial worth or regular resources to justify their subscription of share capital money in the assessee company. He held that the assessee had failed to discharge the onus is proving the identity of the creditors/subscribers, genuineness of the transactions and the creditworthiness and, accordingly, made an addition in the hands of the assessee.

Appeal was preferred by the assessee and the Commissioner (Appeals) noted that the assessee had filed confirmation letters which contained the addresses, PAN numbers and other details, and, thus, assessee had discharged its burden of proving basic details that were required for verification to fulfil the conditions i.e. identity of creditors, creditworthiness of the creditors and genuineness of transactions.

He held that the assessee could not be penalized for the mistakes/faults committed by the share applicants and that the Assessing Officer had not found any discrepancy in the bank accounts maintained by the assessee. The Tribunal confirmed the said order.

The matter came up before the High Court of Delhi and was opined that the orders of the Commissioner (Appeals) and the Tribunal in deleting the additions made by the Assessing Officer under section 68 are perverse and are clearly unsustainable. The High Court observed that:

- The assessee is private limited company and shares are not offered to the public at large.
- The persons who are subscribing to the share capital of the company should be well known i.e. either they may be friends/relatives.
- The subscriber's bank account statements furnished were forged and fabricated as there were corresponding cash deposits in the bank accounts before issue of share application cheques.
- The subscribers did not bother and ensure protection of their investment.
- Merely submission of the PA number of allottees do not render the transactions as genuine since PAN Numbers are allotted on the basis of applications without actual *de facto* verification of the identity or ascertainment of the active nature of business activity. PAN number is allotted as a facility to revenue to keep track of transactions and thus, the PAN number cannot be blindly and without consideration of surrounding circumstances treated as sufficiently disclosing identity of the individual.
- Mere production of PA number or assessment particulars does not establish the identity of a person. The identification of a person includes the place of work, the staff and the fact that it was actually carrying on business and further recognition of the said company individual in the eyes of public.
- The mere filing of share application is not enough as the said application is not an unimpeachable document and does not on its own prove the genuineness or authenticity of the transaction. It can at best be treated as a corroborative document.
- The bank statements of the investors furnished by the assessee during the original assessment proceedings were fabricated and misleading. They omitted to show that there was deposit of cash immediately prior to issuance of cheques for preparation of pay orders or DDs in favour of the assessee regarding subscription of its share capital.
- False evidence had been adduced by the assessee during the original proceedings to get undue advantage of giving colour of genuineness to bogus entries through the bank accounts.

- With regard to the share the Assessing Officer has noticed that the pay order/DDs in respect of both the companies were made out of the bank account of one of said companies. The Assessing Officer has held that the transactions in the bank accounts showed that there was a corresponding withdrawal of the amount in cash on the very same day of the crediting of cheques and there was immediate issuance of cheques/DDs on deposit of cash.

- The High Court of Delhi therefore opined that keeping in view of the above, that the assessee has not discharged the onus satisfactorily and the additions made by the Assessing Officer was justified and sustainable and the order of the Tribunal ignoring and not dealing with the factual findings recorded by the Assessing Officer is perverse.

11. Special leave petition was filed in the Supreme Court against the order of the High Court of Delhi. The Supreme Court dismissed and affirmed the decision of the High Court.

12. Other decisions of High Courts:

a) In the case of ***Commissioner of Income-tax v. Empire Builtech (P.) Ltd.(2014) 366 ITR 110(Delhi HC)***, the High Court of Delhi held that in case of receipt of Share application money (cash credit), the initial burden is upon assessee to show as to genuineness of identity of individuals or entities which seek to subscribe to share capital. It is not sufficient to merely disclose addresses or identities of individuals or entities concerned. Assessee company issued shares at 1000 per cent premium. In response to notices under section 133(6), investors not only did not submit any confirmation but had concededly reported far less income than amounts invested. Hence, addition u/s 68 was justified.

b) In the case of ***Commissioner of Income-tax, IV, New Delhi v. Focus Exports (P.) Ltd(2014) 111 DTR 12 (Del. HC)***, the Delhi Court opined that where in respect of share application money, the assessee failed to provide complete address and PAN of certain share applicants and in case of some of share applicants, there were transactions of deposits and immediate withdrawals of money from bank, the additions made by the Assessing Officer under section 68 were justified.

c) In case of ***Commissioner of Income-tax, Central Circle, Salem v. Victory Spinning Mills Ltd. 228 Taxmann 69 (Mag.)***, the High Court of Madras, held that where share applicants of assessee company had appeared when summons were issued and they had accepted their investment, share application money could not be treated as cash credit in hands of assessee.

d) In the case of ***Commissioner of Income-tax v. Navodaya Castles (P.) Ltd 56 Taxmann.com 18***, the High Court of Madras expressed that certificate of incorporation, PAN, etc., are relevant for purpose of identification, but have their limitations, when there is sufficient evidence and material to show that subscriber was a paper company and not a genuine investor. In case of private limited companies, generally persons known to directors or shareholders, directly or indirectly, buy or subscribe to shares.

Upon receipt of money, the share subscribers do not lose touch and become incommunicado. Call money, dividends, warrants, etc., have to be sent and the relationship remains a continuing one. Therefore, an assessee cannot simply furnish some details and remain quiet when summons issued to shareholders remain un-served and un-complied.

As a general proposition, it would be improper to universally hold that the assessee cannot plead that they had received money, but could do nothing more and it was for the Assessing Officer to enforce shareholders' attendance in spite of the fact that the shareholders were missing and not available. Their reluctance and hiding may reflect on the genuineness of the transaction and creditworthiness of the creditor.

It would also be incorrect to universally state that an Inspector must be sent to verify the shareholders/ subscribers at the available addresses, though this might be required in some cases. Similarly, it would be incorrect to state that the Assessing Officer should ascertain and get addresses from the Registrar of Companies' website or search for the addresses of shareholders themselves. Creditworthiness is not proved by showing issue and receipt of a cheque or by furnishing a copy of statement of bank account, when circumstances require that there should be some more evidence of positive nature to show that the subscribers had made genuine investment or had, acted as angel investors after due diligence or for personal reasons. The final conclusion must be pragmatic and practical, which takes into account holistic view of the entire evidence including the difficulties, which the assessee may face to unimpeachably establish creditworthiness of the shareholders.

e) In the case of ***Commissioner of Income-tax (Central) v. Vacmet Packaging (India) (P.) Ltd (2014) 367 ITR 217 (All. HC)***, the Assessing Officer made addition under section 68 on account of share application money received by assessee company even though assessee had filed all documentary evidence, like share application form, copies of bank statement, income-tax return, balance sheet, share allotment certificates of board resolution of share applicants, PAN card, register certificate of Registrar.

Moreover, applicant companies also confirmed investment made by them and submitted all relevant documents. The High of Court of Allahabad held that since assessee had discharged onus in establishing identity and creditworthiness of applicant companies and genuineness of transaction, the addition made by Assessing Officer under section 68 was to be deleted.

f) In the case of ***DCIT v. M/s Soni Hospital Pvt. Ltd. [ITA No. 588/JP/2011]*:-**

Brief of the case:

In the case of *DCIT v. M/s. Soni Hospital Pvt. Ltd*. Jaipur bench of ITAT have held that that in case of share capital, the creditworthiness along with genuineness of transaction, identity of person is also required to be proved by the assessee. ITAT considered the decision of Hon'ble SC in the case of M/s Lovely Exports and found that assessee was required to prove the identity, genuineness and creditworthiness.

Facts of the case:

- Assessee is running a hospital and files its return of loss of Rs. 2,82,73,070/- on 31.10.2005.
- There was a search on M/s. B.C. Purohit & Co. on 12.04.2005 and detailed investigation was made by the Department on the basis of evidence collected.
- On the basis of this search, the assessee was also covered under section 133A of the IT Act in survey proceedings on 03.05.2005 to confront these evidences.
- The Assessing Officer observed that during the course of investigation being conducted by the Investigation Wing it was noticed that some entries from the bogus entities being run by these racketeers had gone to Soni Hospital Ltd., Jaipur.
- In order to verify these entries and confront this party about the non-genuineness of these entries a limited purpose survey was conducted u/s 133A at the office premises of hospital with the authorization issued by the Addl. DIT, Jaipur.
- The Assessing Officer further observed that during the course of survey operation it was found that share application money was shown as received by this company from certain entities being operated by M/s. B.C. Purohit & Co. Group.
- The MD of the assessee company was confronted with the findings of non-genuineness of these parties from whom loans were shown in the books of accounts of his company.
- However, MD did not accept that the transactions relating to receipt of share application money are not genuine.
- As a result of the evidences gathered during the search operation and the investigations conducted subsequently it was found that in the guise of tax consultation the owners and employees of his group were running a big racket of providing accommodation entries of gifts, loans, share application money, share investment and long term capital gains in shares.
- The Assessing Officer observed that the assessee had taken entries during the financial year 2004-05 relevant to the assessment year 2005-06 mostly from the bogus companies operated by the impugned entry operators.
- Assessing Officer found entries of Rs. 79,00,000/- are in the form of share application money which have been received from M/s. B.C. Purohit Group.
- Assessee was asked to produce the relevant parties for examination.
- Assessing Officer concluded that it has been clearly established that the companies and individuals in whose names the assessee had shown share application money of Rs. 79,00,000/- were engaged in providing accommodation entries.

- The assessee had also obtained accommodation entries and had not received any genuine share application money and had thus introduced its own undisclosed income in the account books, which was added to the income of the assessee.
- Assessing Officer further found that assessee had raised share application money of Rs. 20,00,000/- from various parties.
- The assessee was failed to satisfy the AO to prove the genuineness of the transaction of share application money of Rs. 20,00,000/- so AO treated this money to have been invested out of undisclosed income of the assessee itself as accommodation entries.
- The assessee submitted copy of financial statements, copies of balance sheets, PAN, and P&L A/c of the companies as additional evidences before the Commissioner of Income-tax (Appeals).
- Remand report was sought by Commissioner of Income-tax (Appeals) but AO didn't submit remand report.

Contention of the assessee:

- There is no basis for treating the amount received from the said parties as bogus as the amount was received from the said parties through banking channel.
- All the parties are income tax assessees and PANs have been allotted to them after having their identity and addresses.
- All of them are maintaining bank accounts and no bank account can be opened without any introducer.
- All these facts established that the parties are genuine and so the amount contributed as share capital is also genuine.
- The assessee had received share application money through banking channel which proved that applicant is existed and is a living person because an account was opened by the bank as per the Reserve Bank of India norms.
- It was further argued that Hon'ble Rajasthan High Court in the case of *CIT v. Supertech Diamond Tools Pvt. Ltd. (2015) 229 Taxman 62 (Raj.)(HC)* wherein addition made under section 68 on the basis of Third Party statement made behind the back of the assessee and no opportunity of being heard or cross examining Third Party was provided to the assessee and confirmed the order of the lower authorities for deleting the addition.
- Hon'ble Allahabad High Court in case of *CIT v. Vacmet Packaging (India) Pvt. Ltd., (2014) 367 ITR 217 (All.)* held that assessee had filed documentary evidence consisting of share application forms, copies of bank accounts of the share applicants, copies of the income-tax returns of the share allottees, balance sheets and copies of share allotment certificates and of the Board's Resolution of the share applicants, and on that basis the Hon'ble High Court held that variation of the transaction had been established by calling the documents and assessee has discharged its onus establishing the identity, creditworthiness and genuineness of the transaction.

Contention of revenue:

- The assessee had not filed any evidence regarding genuineness of share application money and also not filed confirmations or copies of their bank statements and also not produced them for examination of the persons.
- Statements of various persons were recorded during search which indicates that the assessee had obtained only accommodation entries and not any genuine share application money.
- The company has accepted the share application money through entries of operators who provided the fund in the guise of share application money.
- It is evident from the investigation made by the Department as well as notice issued by the Assessing Officer for production of these parties that it can easily be concluded that money received through share application money by the assessee is undisclosed income of the assessee.
- The investors had not submitted any confirmation and reporting for less income than amount invested.

- In case of *CIT v. T.S. Krishna & Co. Ltd., 315 ITR 163*, the Hon'ble Delhi High Court has held that burden of prove is on the assessee to prove genuineness of the transaction, creditworthiness of creditor, identity of the creditor.

- The Hon'ble Delhi High Court in case of *CIT v. Youth Construction Pvt. Ltd. (2013) 357 ITR 97 (Del.)* has confirmed the share capital under section 68 on the ground of creditworthiness and genuineness has not been proved by the assessee.

- It is further held by the Hon'ble Supreme Court in the case of *N. Tarika Property Invest (P) Ltd. vs. CIT, (2014) 51 Taxmann.com 387 (SC)* that PAN blindly cannot be accepted as a proof for identity of individuals as it is generally issued without ascertaining the active nature of business activities.

Held by Commissioner of Income-tax (Appeals):

- Commissioner of Income-tax (Appeals) concluded that Assessing Officer had failed to make further enquiry as desired from him. In absence of remand report, the Commissioner of Income-tax (Appeals) decided the appeal on the basis of evidences filed by assessee and concluded that nothing adverse was narrated in the documents filed by the assessee.

- Commissioner of Income-tax (Appeals) Allowed appeal of assessee in the light of decision of Hon'ble Delhi Tribunal in the case of *A-One Housing Complex Ltd. (299 ITR AT 327)* that the onus on the assessee in the case of share capital by public issue was a lighter one and therefore such onus would stand discharged if the identity of the share applicant was established.

- There was nothing wrong if confirmations were prepared by the assessee and got signed from the share applicants since the assessee was required to prove only the identity of the share applicant.

- There was nothing wrong if some of the shareholders had accounts with the same bank. It was not the case of the Revenue that such accounts were bogus or operated by the assessee.

Held by ITAT:

- As per Annexure-A3 seized during the course of search revealed that there was an entry of cheque and cash received from various parties. There are number of companies on page 20 of this Annexure-A3 and on page 21 there were details of entries provided with amount.

- The name of the assessee company also figured on these pages and the modus operandi admitted by Shri Kripa Shankar Sharma in his statement recorded on 12.04.2005 that cash was received from the entry receiver parties and cheques were issued through various companies opened by Shri Bal Chand Purohit Group.

- It is further found fact that Shri Sunil Verma, a peon, has been shown as Director in number of companies who had also admitted on 26.04.2005 that these companies did not have any business but providing entries by receiving cash from the beneficiaries and after depositing in the bank account of these companies, cheques are issued to the beneficiaries.

- Some of the companies' addresses were found on vacant plots.

- The Assessing Officer issued notices under section 133(6) of the IT Act for verification but notices were received back with postal remarks " *no such party exists at the given address*", in case of share capital of Rs. 20,00,000/-.

- The Commissioner of Income-tax (Appeals) followed the Hon'ble Supreme Court decision in case of *M/s. Lovely Exports [(2009) 319 ITR 0005 SC]*. But recently Hon'ble Bombay High Court in the case of *M/s. Major Metals Ltd. v. UOI, (2013) 359 ITR 450 (Bom.)* by following Supreme Court decision in the case of *Lovely Exports, 319 ITR 5 (SC)* has held that creditworthiness and financial standing of the cash creditor is to be proved by the appellant under section 68 of the Act.

- Recently Hon'ble Delhi High Court in case of *CIT v. T.S. Krishna Kumar & Co. Ltd., 370 ITR 163* has held that under section 68 the identity, genuineness and creditworthiness of the cash creditor is to be proved by the appellant.

- In case of share capital, the creditworthiness along with genuineness of transaction, identity of person is also required to be proved by the assessee, which remained disproved in this case.

- Hence appeal of the revenue allowed.

13. There must exist books of accounts before making addition under Section 68: The addition under Section 68 can be made on the basis of unexplained cash credit found in the books of the asseessee, hence existence of books of an assessee is a condition precedent before an addition under Section 68 can be made.

1. Now the question is what may be termed as books of the assessee. As per Section 2(12A) of Income-tax Act books includes ledgers, day books, cash books, whether kept in the written form or as print outs of data stored in floppy, disc, tape or any other electro-magnetic data storage device.

2. In ***Central Bureau of Investigation v. V.C. Shukla [1998] 3 SCC 410***, the Supreme Court has held that '*Book*' ordinarily means a collection of sheets of paper or other material, blank, written or printed, fastened or bound together so as to form a material whole. Loose sheets or scraps of paper cannot be termed as book for they can be easily detached and replaced.

3. Books of accounts must be of assessee himself and not of any other assessee. In ***Smt Shanta Devi v. CIT [1998] 171 ITR 532 (P&H)***, it was held that a perusal of Section 68 would show that the expression books has been used with reference to the word assessee. In other words, such books of account have to be books of the assessee himself and not of any other assessee. Thus books of account of a partnership firm cannot be considered to be the books of account of the partner. Any cash credit shown therein cannot be brought to tax as income under Section 68 in the hands of the partners.

4. Bank Pass book is not books of account for the purpose of Section 68. In ***CIT, Poona v. Bhaichand H. Gandhi 141 ITR 67 (Bom.)*** it was held that the pass book supplied by the bank to the assessee cannot be regarded as the book of the assessee, that is, a book maintained by the assessee or under his instructions. Therefore a cash credit for the previous year shown in the assessee's bank pass book but not shown in the cash book maintained by the assessee for that year, does not fall within the ambit of Section 68 of Income-tax Act, 1961, thus if Assessing Officer finds any unexplained transaction in the bank passbook of the assessee then same can be taxed as unexplained money under Section 69A of the act.

5. It is not necessary that books of account must be rejected before making any addition under Section 68. In ***Devinder Singh v. ACIT [2006] 101 TTJ 505 (ITAT-Asr)*** it has been held that there is nothing in Section 68 that books of account must be rejected before making an addition under Section 68. This is an independent and deeming provision and will apply if the assessee fails to offer an explanation of the source of particular receipt/credit appearing in the books of account or if the explanation given by the assessee is found to be not satisfactory by the Assessing Officer.

   Firstly, credit should appear in the Books of accounts of the assessee himself. Therefore credit shown in the bank pass book but not shown in the cash book for the year cannot be added u/s 68 of Income-tax Act, 1961. It will be different matter as the same can be added to total income as unexplained investment u/s 69 or 69A of the Income-tax Act. **However what can be added u/s 69 cannot be added u/s 68 as has been held in the case of *CIT v. Jauharimal Goel* reported in *296 ITR 263*.**

   The Assessing Officer has to make proper enquiry before making any addition under Section 68. **Not only that, if the assessee asks the Assessing Officer to issue notice u/s 131, the Assessing Officer is duty bound to issue such notice as has been held in the decisions reported in *112 TTJ 455*.** Even commission has to be issued on request. (*Niranjanlal Ramvallabh v. CIT 29 ITR 459*).**The assessee is equally entitled to cross-examine the person who was examined by the Assessing Officer *(CIT v. Eastern Commercial Enterprises (1994) 210 ITR 103 (Cal.).*** Not only that if the Assessing Officer wants to use some statement made before him, then on request by the assessee, is bound to put the deponent for cross examination **(*Dr. G G Dhir v. ACIT 129 TTJ 1)*** and if the statement made is found to be false the same cannot be relied on ***Babulal C. Borana v. ITO 282 ITR 251 at page 258***. Further a statement cannot be relied on which is not corroborated by any other evidences as has been held by Hon'ble Calcutta High Court in the case of ***CIT v. Dwarka Pd. Bajaj* reported in *168 ITR 572, PG Foils Ltd.v. ITSC & Anr.* reported in *302 ITR 331*, *CIT v. Uttamchand Jain* reported in *(2010) 320 ITR 554 (Bombay)*.** The Assessing Officer has to bring evidence on record that the evidences filed by the assessee were not reliable and cannot simply rely on an uncorroborated communication.

14. Proper enquiry must be made by Assessing Officer before making any addition under Section 68: The Assessing Officer must make proper enquiry before making any addition under Section 68. In ***Khandelwal Constructions v. CIT (1997) 227 ITR 900 (Gau.)*** it has been held that Section 68 of Income-tax Act, 1961, empowers the Assessing officer to make enquiry regarding cash credit. If he is satisfied that these entries are not genuine he has every right to add these as income from other sources. But before rejecting the assessee's explanation Assessing Officer must make proper enquiries and in the absence of proper enquiries, addition cannot be sustained.

The assessee is also entitled to cross-examine any person whose statement has been recorded by the Assessing Officer and such statement is proposed to be used by the Assessing Officer ***CIT v. Eastern Commercial Enterprises (1994) 210 ITR 103 (Cal.)*.**

If some depositor or any other person with whose evidence cash credit in question can be proved, does not cooperate in the assessment proceedings with the assessee concerned, then assessee can also take assistance of Section 131 of the Act wherein ample powers have been given to the Assessing Officer for compelling the attendance of witnesses.

15. In the cases where credit entry has been made in the books of the assessee, the ambit of Section 68 is wide and inclusive. Provision applies to all credit entries. The language of Section 68 shows that it is general in nature and applies to all credit entries in whomsoever name they may stand, that is, whether in the name of the assessee or a third party as held in the case of ***Gumani Ram Siri Ram v. CIT [1975] 98 ITR 337 (Punj. & Har.).*** The section has applicability even in the cases of search as Section 68 is a provision of general application and there is nothing either in Section 132 or Section 68 or elsewhere to exclude the application of this general provision to a case where the business premises or the residence of a person has been searched and the documents and other things seized under Section 132 of the Act. The presumption under Section 132(4A) does not override or exclude Section 68, that is, it does not obviate the necessity to establish by independent evidence the genuineness of the cash credits under Section 68, nor does it do away with the burden which is on the assessee to establish the requisites of cash credits as held in the cases of ***Pushkar Narain Sarraf v.CIT [1990] 183 ITR 388 (All.)*** **and** ***Daya Chand v. CIT [2001] 250 ITR 327 (Delhi).***

16. It is obvious by the above that the provision applies to non-commercial loans as well and it was precisely the same as held by the Hon. Calcutta High Court in the case of ***C. Kant & Co. v. CIT [1980] 126 ITR 63 (Cal.),*** observing that Section 68 does not make any distinction between commercial and non-commercial loans.

In ***Asstt. CIT v. Venkateshwar Ispat (P) Ltd. (2009) 319 ITR 393 (Chhattisgarh HC)*,** following the view in *CIT v. Lovely Exports (P) Ltd. (2009) 319 ITR (SC) 5*, it was held that where in a case, if share money was received by assessee from alleged bogus shareholders whose names were given to Assessing Officer, then department was free to proceed to reopen their individual assessments but it could not be regarded as undisclosed income of assessee. In ***CIT v. Divine Leasing & Finance Ltd. (2007) 16 (I) ITCL 377 (Del-HC)*,** the High Court held that there are the following propositions of law in the context of section 68 of the Income-tax Act. 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 or other indisputable channels;

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

(4) if the relevant details of the address or PAN identity of the creditor/ subscriber are furnished to the department along with copies of the shareholders register, share application forms, share transfer register, etc. it would constitute acceptable proof or acceptable explanation by the assessee;

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

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

(7) the Assessing Officer is duty bound to investigate the creditworthiness of the creditor/subscriber, the genuineness of the transaction and the veracity of the repudiation.

The court finally held that where all required details had been furnished to Assessing Officer by the assessee but he failed to investigate into the creditworthiness of the share applicants in such circumstances, no addition could be made under section 68.

17. In ***CIT v. Lovely Exports (P) Ltd. (2009) 319 ITR (SC) 5,*** SLP was filed before Supreme Court and question before court was: can the amount of share money be regarded as undisclosed income under section 68 of Income-tax Act, 1961? It was held that no merit is found in SLP for the simple reason that if the share application money is received by the assessee-company from alleged bogus shareholders, whose names are given to the Assessing Officer, then the department, is free to proceed to reopen their individual assessments in accordance with law.

Once identity of shareholder is established and they accept the fact of investment made in shares of that company, ordinarily burden which lies on assessee-company under section 68 will stand discharged. In ***CIT v. K.C. Fibres Ltd. (2011) 332 ITR 0481*** M/s. Diamond Protein Ltd. subscribed to the share capital of the assessee-company. Assessing Officer after making enquiries of the assessee-company concluded that a sum of Rs.25 lakhs subscribed by M/s. Diamond Protein Ltd., remained unexplained under section 68 and added as an income of assessee. On appeal, Commissioner (Appeals) deleted addition. On revenue's appeal, Tribunal upheld Commissioner (Appeal)'s order. It was argued that 111 deposits of Rs. 19,000 each in cash were made in the bank account and were converted in drafts by M/s. Diamond Protein Ltd., and in this manner, share capital was subscribed. It was for the Assessing Officer to inquire into the affairs of M/s. Diamond Protein Ltd., which was an independent company, inasmuch as no finding was arrived at by the Assessing Officer that the two companies umbrella companies or had any relationship with each other. Order affirmed by the Tribunal, was correct.

The share application money is generally an initial payment made by an investor for the purpose of purchase of share. This amount denotes the partial ownership towards the company and unlike debentures, the amount cannot be considered as loan. Private companies generally collect share capital from close relatives and friends who may circulate unaccounted money through share capital. Therefore, it was considered necessary that assessee company show cause the capacity or credit worthiness of the person from whom the amount is received by the assessee.

The share application money or the share capital received by an assessee (company) was considered to be adequate disclosure as the assessee cannot generally collect the source of such source from the prospective shareholder of the assessee. Also the court were of the view that once the company has given the details of the person from whom the share application money was received, the department is at liberty to proceed against those person. Thus, it was found to be unjustified on the part of the department to add the application money received by the assessee as unexplained cash credit under section 68 of the Act.

18. The Hon'ble Delhi High Court in the case of ***CIT v. Stellar Investment Limited (1991) 192 ITR 287 (Del.)*** held as under:

"It is evident that even if it be assumed that the subscribers to the increased share capital were not genuine, nevertheless, under no circumstances, can the amount of share capital be regarded as undisclosed income of the assessee. It may be that there are some bogus shareholders in whose names shares had been issued and the money may have been provided by some other persons. If the assessment of the persons who are alleged to have really advanced the money is sought to be reopened, that would have made some sense but we fail to understand as to how this amount of increased share capital can be assessed in the hands of the company itself."

19. The Hon'ble Delhi ITAT in the case of *A-One Housing Complex Ltd. v. ITO (2008) 299 ITR 0327 (Del)* observed as under:

"13. However, the pertinent question for our consideration is when the onus as assessee can be said to be discharged. In our humble opinion, the degree of onus would depend on the facts of each case and no standard degree of proof can be applied in all cases irrespective of the nature of receipt. It may be stringent or light depending upon the facts of the case. We would like to explain through examples hereafter.

(a) The amount may be received from close relatives or friends by way of loan or deposit or gift or otherwise. In such situation, the onus would be stringent since the assessee is supposed to know all the particulars of such creditors.

(b) In the case of deposits received by a money lender or a bank, the onus would be lighter as such banker is not supposed to know all the particulars of general public. Any person whether a millionaire or beggar can come to a bank and open the account with such banker. The banker is not supposed to know the source of money deposited by his customers. Hence, the onus would be lighter than the one mentioned in example (a). Similar would be the position where share capital is received through public issue since the company is not supposed to know about the source from which share applicant makes the investment.

(c) The position would be different where the shares are issued by a private limited company. The reason is that the public issue cannot be made by a private limited company. However, with requisite permission, the share capital can be received through private placement normally to known persons i.e. the relatives and friends of directors. In such cases, the onus would be heavy on the assessee as held by Delhi Bench of the Tribunal in the case of Finquick. Similar would be the position even when shares are allotted by public limited company on private placement basis as observed by the Jurisdictional High Court in para 6 of the judgment in the case of Divine Leasing & Finance Ltd. (supra).

(d) *Where the payment is received in cash or by demand draft, the standard of proof would be rigorous and stringent than where the transaction is by cheque where the date and source of the investment cannot be manipulated as observed by the Hon'ble Delhi High Court in para 11 of its judgment in the case of Devine Leasing & Finance Ltd. (supra).*

The above situations are illustrative and not, exhaustive. By giving these examples, the purpose is to point out that no standard proof is required to discharge the onus which lies on the assessee. It would be stringent or light depending upon the facts of the case."

20. This issue discussed and decided in various judicial forums was finally settled with the verdict of the Hon'ble Supreme Court in the case of *CIT v. Lovely Exports (P) Ltd. (2009) 319 ITR 0005* which held as under:

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

21. The above held proposition of the Hon'ble Supreme Court was followed various High Courts and the matter was mostly decided in favour of assessees. Those include:

a) *CIT v. K.C.Fibres (2011) 332 ITR 0481 (Del)*

b) *CIT v. Kamdhenu Steel & Alloys Ltd. (2014) 361 ITR 0222(Del)*

c) *CIT v. Misra Preservers (P) Ltd. (2013) 350 ITR 222 (All)*

d) *CIT v. Peoples General Hospital Ltd. (2013) 356 ITR 65 (MP)*

e) *DCIT v. Rana Girders Ltd. (2013) 84 CCH 128 All HC*

f) *CIT v. Rock Fort Metal & Minerals Ltd. (2011) 198 TAXMAN 497*

22. It is illustrative to note the Hon'ble Madras High Court in the case of ***Rajani Hotels Ltd v. DCIT (2012) 82 CCH 451*** which decided the issue against the assessee for lack of even basic prerequisite evidence as outlined by section 68.The Court observed as under:

"As far as the third substantial question of law is concerned, learned counsel appearing for the assessee submitted that the Tribunal committed a serious error in treating the share capital as an income of the assessee, even though no business was commenced by the assessee. As already pointed out, when the assessee had not substantiated its case before the Assessing Officer as to the persons who had contributed and as to who had made the applications for share allotment, rightly, the Assessing Officer took recourse to Section 68 and the only available course was thus to treat the unexplained amount available at the hands of the assessee as an unexplained income. It is seen from the assessment order that till the date of passing the order of assessment, the assessee had not filed any objection to the proposed addition made. Thus, in the absence of any explanation, the only course open to the Officer was to treat the amount at the hands of the assessee as an unexplained income. In the light of the order passed by us, as indicated above, except to the extent of the relief as stated above, the assessee is not entitled to any relief and hence, the unexplained entries were rightly treated as unexplained income of the assessee."

23. While recognizing that the pernicious practice of conversion of unaccounted money through masquerade of investment in the share capital of a company needs to be prevented, Courts have advised a balance to be maintained regarding onus of proof to be placed on the company. The Courts have drawn a distinction and emphasized that in case of private placement of shares the legal regime should be different from that which is followed in case of a company seeking share capital from the public at large.

The amendment to the section 68 of the Act states that the nature and source of any sum credited, as share capital, share premium etc., in the books of a closely held company shall be treated as explained only if the source of funds is also explained by the assessee company in the hands of the resident shareholder. In other words, the in case of closely held companies the sources of the person from whom the share capital is received is also required to be produced by the assessee so as to escape the clutches of section 68. And where they are not regulated by SEBI, the assessee is now under an obligation to prove the source the person from whom the amount is received by the assessee.

24. However, this additional onus of satisfactorily explaining the source in the hands of the shareholder, would not apply if the shareholder is a well regulated entity, i.e. a Venture Capital Fund, Venture Capital Company registered with the Securities Exchange Board of India (SEBI). This exemption is granted only to the companies (including closely held companies) which are well regulated by SEBI.

25. Recently, even after the amendment, the Hon'ble Mumbai ITAT in the case of ***Green Infra Ltd v. ITO (2014) 159 TTJ 0728(Mumbai)*** held that section 68 of the Act is not attracted being transaction directly or indirectly related to the Government of India and held as under:

"We find that the share holders in all the related transaction under issue are directly or indirectly related to the Government of India. Therefore, considering the entire issue in the light of the material evidence brought on record, in our considerate view, the Revenue authorities have erred in treating the share premium as income of the assessee u/s. 56(1) of the Act. In our considerate view, for the reasons discussed hereinabove, we do not find it necessary to apply the provisions of Sec. 68 of the Act. We, therefore, direct the Assessing Officer *to delete the addition of Rs. 47,97,10,000/-."*

26. Thus, in short it can be stated that no specific formula can be drawn for any particular facts but has to be ascertained by the courts based on facts and circumstances of case.

The Assessing Officer has to enquire specifically to satisfy himself of the source of such credit and if during the enquiry, he is satisfied that the entries are not genuine, then he has every right to add the said sum represented by such credit entry as income of the assessee. The satisfaction of the Assessing Officer is the basis of invocation of provisions of Section 68. However, such satisfaction must not be illusory or imaginary but must have been derived from relevant facts and evidences, and on the basis of proper enquiry of all material before him.

The enquiry envisaged under Section 68 is an enquiry which is reasonable and just. The amount of cash credits could not be included in the total income of the assessee if the Assessing Officer has not made proper enquiry. Under Section 68, the onus is on the assessee to offer explanation where any sum is found credited in the books of account and where the assessee fails to prove to the satisfaction of the Assessing Officer, the source and nature of the amount of cash credits, he is entitled to draw an inference that the credit entries represent income taxable in the hands of the assessee. It is not the duty of the Assessing Officer to locate the exact source of the cash credits. The burden to identify the source lies upon the assessee and he is required to explain the genuineness of the credit entry.

27. The issue of cash credit has always been a matter of vexed litigation. Section 68 enacts a golden rule of evidence which is not in dispute, i.e., if any sum is found credited in the books of account of an assessee, the onus is on him to explain the said entry. The principle embodied in Section 68 is only a statutory recognition of what was always understood to be the law based upon the rule that the burden of proof is on the taxpayer to prove the genuineness of borrowings since the relevant facts are exclusively within his knowledge. Even before the enactment of Section 68, this rule of evidence was applicable vide ***Kale Khan Mohammed Hanif v. CIT [1963] 50 ITR 1 (SC)***. Section 68 does not absolve the responsibility of the Assessing Officer to prove that the cash credits constitute the income of the assessee. In ***Orient Trading Co. Ltd. v. Commissioner of Income-tax (1963) 49 ITR 723 (Bom.)***, one of the questions referred to the Bombay High Court was whether there was any material before the Tribunal to hold that a sum standing in the books of the assessee to the credit of a third party belonged to the assessee. The Bombay High Court discussed the nature and significance of cash credits in such cases and observed as follows:

"*When cash credits appear in the accounts of an assessee, whether in his own name or in the name of third parties, the Income-tax Officer is entitled to satisfy himself as to the true nature and source of the amounts entered therein, and if after investigation or inquiry he is satisfied that there is no satisfactory explanation as to the said entries, he would be entitled to regard them as representing the undisclosed income of the assessee. When these credit entries stand in the name of the assessee himself, the burden is undoubtedly on him to prove satisfactorily the nature and source of these entries and to show that they do not constitute a part of his business income liable to tax. When, however, entries stand, not in the assessee's own name, but in the name of third parties, there has been some divergence of opinion expressed as to the question of the burden of proof. The Income-tax Officer's rejection not of the explanation of the assessee, but of the explanation regarding the source of income of the depositors, cannot by itself lead to any inference regarding the non-genuine or fictitious character of the entries in the assessee's books of account.*"

28. The expression "*nature and source*" in Section 68 has to be understood together as a requirement of identification of the source and the nature of the source, so that the genuineness or otherwise could be inferred. The Law on the subject has been illustrated in a number of decisions prior to 1968. Hon'ble Supreme Court, in ***Kale Khan Mohammed Hanif v. CIT [1963] 50 ITR 1 (SC)***, pointed out that the onus on the assessee has to be understood with reference to the facts of each case and proper inference drawn from the facts. The law after Section 68 is not different. If the *prima facie* inference on the fact is that the assessee's explanation is probable, the onus will shift to the Revenue. Though the Assessing Officers, often, act on confirmatory letters as evidence, the onus does not get discharged merely by such confirmatory letters as found in ***CIT v. United Commercial and Industrial Co. (Pvt.) Ltd. (1991) 187 ITR 596 (Cal)***, nor is the fact that the amount is received by account payee cheques is sacrosanct as was pointed out in ***CIT v. Precision Finance Pvt. Ltd. (1994) 208 ITR 465 (Cal)***. This view was further held in the case of ***Nemi Chand Kothari v. CIT [2003] 264 ITR 254 (Gau.)*** where in it was held that it cannot be said that a transaction, which takes place by way of cheque, is invariably sacrosanct. Once the assessee has proved the identity of his creditors the genuineness of the transactions, and the creditworthiness of his creditors vis-à-vis the transactions which he had with the creditors, his burden stands discharged and the burden then shifts to the revenue to show that though covered by cheques, the amounts in question, actually belonged to, or was owned by the assessee himself. Even the particulars from assessment records, where the creditor is assessed, may not be sufficient as observed in ***CIT v. Korlay Trading Co. Ltd. (1998) 238 ITR 820 (Cal).***

Further, in the case of ***Kamal Motors v. CIT [2003] 131 Taxman 155 (Raj.)***, it was held that the responsibility is on the assessee to discharge the onus that the cash creditor is a man of means to allow the cash credit. The burden to prove the source of receipt is in respect of each entry as held in the case of ***CIT v. R.S. Rathore [1995] 212 ITR 390 (Raj.)***, that while explaining the various credits and investments, it is possible that the assessee may be successful in explaining some of them, but that does not by itself mean that the entire investments has to be considered as explained. It is each and individual entry on which the mind has to be applied by the taxing authority when an explanation is offered by the assessee.

29. On the issue of burden of proof a very specific and illustrious decision was from the Hon. Calcutta High Court in ***CIT v. Precision Finance Pvt. Ltd. (1994) 208 ITR 465 (Cal)*** where in it was laid down that the assessee is expected to establish:-

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

As to the issue of genuineness of transaction, it was further held in the above decision that the transaction is not genuine, simply because some, out of many, of the transactions are by cheque. Conversely, it is not open for the Assessing Officer to add token amount merely for the purpose of making the returned income into a round figure. Where certain sum of money claimed by the assessee to have been borrowed from certain persons, it is for the assessee to prove, by cogent and proper evidence, that they are the genuine borrowings for the reason that the facts are exclusively within the assessee´s knowledge.

30. But at the same time, the law does not expect the impossible on the part of the tax payer as was pointed out in ***Life Insurance Corporation of India v. CIT (1996) 219 ITR 410 (SC)***, although pronounced in a different context. All that matter is that the explanation is *prima facie* reasonable. If it is so, it cannot be rejected on mere surmises. It was so held in ***CIT v. Bedi And Co. Pvt. Ltd. (198) 230 ITR 580 (SC)***. The affidavits filed cannot be rejected outright without cross examination as was found by the Hon'ble Supreme Court in ***Mehta Parikh & Co. v. CIT (1956) 30 ITR 181 (SC)***. It was pointed out that where the assessee's account were accepted as genuine, it is ordinarily not possible to show that the credits therein do not come from the sources attributed for them. These and other decisions would indicate that the ultimate inference in such cases is to draw from the facts and the preponderant probability of such explanation and difficulty in proving an explanation is a fact which cannot be ignored as observed in ***S. Hastimal v. CIT (1963) 49 ITR 273 (Mad.)***. To say that the borrowing has not come from the accounted source of the lender may not be sufficient in itself to reach a presumption as it was held in the case of ***CIT v. Metachem Industries (2000) 245 ITR 160 (MP)*** that there is no further responsibility to show, that it has come from the accounted source of the lender. In the case of ***Jalan Timbers v. CIT [1997] 223 ITR 11 (Gauhati),*** it was held that where, in respect of certain cash credits, the assessee had not only disclosed them in his return of income but also produced confirmatory letters from the creditors, and the creditors had also declared the amounts in their income-tax returns which were accepted by the ITO, addition made as cash credits by ignoring the

aforesaid facts would not be justified. It was also held in the case of ***CIT v. U.M. Shah, Proprietor, Shrenik Trading Co. [1973] 90 ITR 396 (Bom.)*** that If the parties had received the summons but did not appear, the assessee could not be blamed. However, where the summons was returned with the postal remark '*not known*' (and '*not found*'), the said is an endorsement of the presupposed that at the specific address furnished by the assessee the addressee could not be traced. In such cases, the question of issuing a second summons would arise only if the address given earlier was erroneous, and not when it was almost identical as held in the case of ***Ram Kumar Jalan v. CIT [1976] 105 ITR 331 (Bom.).***

31. A decision often referred to by the assessee and tax practitioners on the issue of burden of proof in respect of cash credit is from Hon. Gujarat High Court in the case of ***DCIT v. Rohini Builders (2002) 256 ITR 360 (Guj)***. It was held in this case that mere identification of the source of the creditors even without evidence as to the nature of the income could justify acceptance, where the assessee has given PAN of the creditor and also shows that the amounts were received by account payee cheques. Hon. High Court, in this case, endorsed the findings of the Tribunal that it is not necessary that there should be explanation as to the source of the money on the part of the creditors in every case.

32. It may, however, be understood that the above view was expressed by the Hon. High Court in given facts and circumstances and it does not necessarily mean that in each and every case the onus on the part of the assessee is discharged by merely providing the PAN of the creditors. In fact, there are enough judicial pronouncements favouring Revenue where it has been acknowledged that the burden does not shift merely by providing PAN of the creditors or by simply identifying the source of cash credit. More so, in the cases where efforts have been made by the Assessing Officers to gather evidences by conducting enquiry to examine the truth in respect of the cash credit. In ***CIT v. Vir Bhan & Sons (2005) 273 ITR 206 (P & H)***, it was found that the credits were received by account payee cheques and the creditors were income tax assessees. But the contention of the Assessing Officer was that the assessee did not respond to the requirements of the production of creditors before him for verification. The first appellate authority and the High Court felt that it was possible for the Assessing Officer to have accepted the same or make further enquiries with reference to the files of the creditors, since they were assessees. Even so, the High Court reversing the finding of the Tribunal observed as under:

"*the appellate authorities have failed to appreciate that in the present case the assessee had totally failed to respond to the notice of the Assessing Officer. Further, even if they were of the view that the Assessing Officer should have made cross verification with the records of the creditors available with him, they ought to have directed the Assessing Officer to do so instead of straight way accepting the assessee's version without affording any opportunity to the Assessing Officer to make the verification. In the alternative, the appellant authorities could have themselves verified the material placed before them with the records of the creditors. This has not been done. Accordingly, we are satisfied that the appellate authorities have not dealt with the matter properly.*"

The principle, as envisaged by the Hon'ble High Court in the above case, is one of absolutely liability, in which case the burden does not shift. Further, mere mention of income-tax file number of creditor will not suffice to discharge the onus as held in the case of *CIT v. Korlay Trading Co. Ltd. [1998] 232 ITR 820 (Cal.),* where in it was held that where, without filing confirmation letter from the creditor, the assessee merely mentioned the income-tax file number of the creditor (which was also not supported by any affidavit from the creditor), the genuineness of the cash credit cannot be said to have been proved by the assessee.

33. In fact, the principle of onus, that the assessee is required to establish the identity, prove the genuineness of the transaction and establish the creditworthiness of the donor, has been reiterated even in a recent decision of Hon. Delhi High Court in the case of ***CIT v. Oasis Hospitalities (P). Ltd., 333 ITR 119 (Delhi)(2011)***. In this case it was held by the Hon. Court 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. Only when these three ingredients are established prima facie, the department is required to undertake further exercise."*

Prima facie onus is always on the assessee to prove the cash credit entry found in the books of account of the assessee. In land mark cases like ***Kale Khan Mohammed Hanif v. CIT [1963] 50 ITR 1 (SC), Roshan Di Hatti v. CIT [1977] 107 ITR 938(SC)*** it has been held that the law is well settled that the onus of proving the source of a sum of money found to have been received by an assessee, is on him. Where the nature and source thereof cannot be explained satisfactorily, it is open to the revenue to hold that it is the income of the assessee and no further burden is on the revenue to show that the income is from any particular source. It may also be pointed out that the burden of proof is fluid for the purposes of Section 68. Once assessee has submitted basic documents relating to identity, genuineness of transaction and creditworthiness then Assessing Officer must do some inquiry to call for more details to invoke Section 68.

34. The Delhi Bench of Tribunal observed in ***Standard Cylinders (P.) Ltd. v. ITO (1988) 24 ITD 504 (Del-Trib)*** that, as far as the company is concerned, the onus regarding funds credited in its books gets fully discharged if the funds in question represent funds for investment made in its shares. Law does not cast a burden higher than the burden of proving the source. Law does not entitle an Assessing Officer to insist from the assessee that he should not only prove the source but also the source of the source of investment. The shareholders whose names were duly registered in the register after having made the investment could not deny that they had not subscribed to the shares standing in their names and if they could not deny, it was for them and not for the company to account for the source of interest on their own assessment proceedings and not in the assessment proceedings of the company. On the facts of the case it was held that a consideration of section 68 by the Assessing Officer also does not affect the finding that the enquiry from company about the source of investment of its shareholders in the shares of company was unauthorised and uncalled for in the assessment of the company.

35. In ***CIT v. Value Capital Services (P) Ltd. (2008) 307 ITR 334 (Del),*** it was held that if the existence of applicant is, proved, no further inquiries are necessary. It is difficult for the assessee to show the creditworthiness of strangers. That the additional burden is on the revenue to show that even if the applicant does not have the means to make the investment, the investment made by the applicant actually emanated from the coffers of the assessee so as to enable the investment to be treated as the undisclosed income of the assessee.

36. Judicial pronouncements, while recognizing that the pernicious practice of conversion of unaccounted money through masquerade of investment in the share capital of a company needs to be prevented, have advised a balance to be maintained regarding onus of proof to be placed on the company. The courts have drawn a distinction and emphasized that in case of private placement of shares, the legal regime should be different from that which is followed in case of a company seeking share capital from the public at large.

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 credit worthiness 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.

37. However, burden of proof is always on the assessee to prove cash credits. The landmark judgement elucidating the nature of onus cast u/s 68 on an assessee is that of ***Shankar Industries v. CIT (1978) 114 ITR 689 (Cal)***. The principle laid down is to be found on page 698 in the following words:- "*We would like to observe that the law on this point is now well settled. It is necessary for the assessee to prove prima facie the transaction which results in a cash credit in his books of account. Such proof includes proof of the identity of this creditor, the capacity of such creditor to advance the money and, lastly, the genuineness of the transaction. These things must be proved prima facie and only after the assessee has adduced evidence' to establish prima facie in the aforesaid, the onus shifts on the Department. In the instant case, it seems that the assessee established only the identity of the creditor and nothing more*." Therefore the assessee has to submit the primary evidence of the cash credits i.e. the confirmation from the creditor with PAN which can prove the identity of the party and has further to prove the nature and source as well as the genuineness of the transaction. Further when confirmations were filed and the Assessing Officer did not proceed further and did not issue any notice u/s 131 to those companies and their directors, the addition is not justified as has been held by the Supreme Court in the case of ***CIT v. Orissa Sales Corporation*** **reported in *159 ITR 78*.**

38. In recent years one of the additions on account of cash credits was related to the share application money. Initially the closely held companies used to issue share capital at face value but then issue at some premium and gradually alarmingly high premium were being raised because of over ambitious operators. This naturally was eye opener for tax collectors perspective. The issue with regard to the onus of proof in case of share capital contribution came up for consideration before various courts and the issues were initially decided on the facts of each case. However, later the principles emerged were that in case of issue of share capital, the onus of the recipient was discharged once the identity of the applicant was proved. Some of the judgments in favour of the assessee are cited hereunder:-

39. Madras High Court in ***Commissioner of Income-tax v. Electro Polychem Ltd. [2007] 294 ITR 661*** held that share application money in fictitious names not to be treated as undisclosed income of company and even if subscribers to increased capital were not genuine, share capital cannot be regarded as undisclosed income of assessee company.

40. It has been held in the case of ***C.I.T. v. Kinetic Capital Finance Limited*** **reported in *354 ITR 296*** that the Assessing Officer has to advert to each and every entry and not pick up a couple of entries and label the entire set of deposits made during the assessment year and undisclosed income of the assessee. However the recent trend appears to be in the reverse gear and the theory of onus of proof and three ingredients of such onus have been made applicable in case of share applications too. Such judgments may be cited as under:-

41. The Hon'ble High Court of Delhi in the case of ***Commissioner of Income-tax v. Frostair (P.) Ltd.*** IT Appeal Nos. 183 of 2002 & 1638 of 2006 on August 24, 2012 held that where it is found that the share capital was received from companies engaged in providing bogus entries at a premium of Rs. 900/- each, the nature of the company and its business was not such as to attract a premium of Rs. 900/- per share, share applicants were not known to the assessee, the concerned Assessing Officers notified that no such company existed in their ward or circle, the Assessing Officer issued summons in response to which none of the addresses were found correct, one person accepted summons on behalf of all the parties and represented all companies , the assessee failed to produce the principal officers of the companies with their books of accounts but sent six envelopes containing information and copies of bank accounts and that too from one post office, it can be said that identity and credit worthiness were not proved. The Assessing Officer further found that the share applicants operated from one Bank which were introduced by one person, credit entries were made through transfers, cash was deposited in one account and from this account, the amount transferred to the account from where the cheques for share application monies were cleared, and after analysing but following the judgment of the Hon'ble Supreme Court in *CIT* v. *Lovely Exports (P.) Ltd. (2009) 319 ITR 0005,* and on a proper application of the *ratio* in *Oasis* - and subsequently, the Division Bench ruling in *CIT v. Nova Promoters & Finlease (P) Ltd [2012] 206 Taxman 207* and after a painstaking examination of the records after two or three layers of scrutiny it was held that the claim that the amounts were received on account of share applications was not accepted. Similarly the Indore Bench of ITAT in the case of *Vaibhav Cotton Pvt. Ltd., Indore v. ACIT* on 2 July, 2012 in I.T.A.No.253/ Ind/2010 after analyzing number of judgments on cash credits and the provisions of Companies Act, decided against the assessee. The Income Tax Appellate Tribunal Hyderabad Bench in ITA No. 115/Hyd/ 2012 in the case of *M/s. Mancherial Cement v. Income-tax Officer*, on 18.01.2013 after considering various judgments held that even after the judgment of Hon'ble Supreme Court in the case of *Stellar investments Ltd.* the burden of proving the existence of shareholders is still upon the assessee.

42. The High Court of Delhi vide its judgment dated 7th January, 2013 in *ITA No. ITA 120/2012* in the case of ***NIPUN BUILDERS & DEVELPERS PVT. LTD.*** in an assessment u/s 143(1)/147 (on the basis of a report of the investigation wing of the income-tax department) held that u/s 68 the onus is upon the assessee to prove the three ingredients, i.e., identity and creditworthiness of the person from whom the monies were taken and the genuineness of the transaction and that the assessee and the Assessing authority – to adopt a reasonable approach. Once the monies are received and shares are issued, it is not as if the share-subscribers and the assessee-company lose touch with each other and become incommunicado. It is a continuing relationship. It cannot be contended, that if the summons issued u/s. 131 to the subscribing companies at the addresses furnished by the assessee returned unserved, the Assessing Officer is duty bound to enforce their attendance with all the powers vested in him. An assessee cannot take an unreasonable attitude towards his onus u/s. 68. When the subscribing companies have not been found existing at the addresses given by the assessee, it is open to the Assessing Officer to even hold that the identity of the share-subscribers has not been proved, let alone their creditworthiness and the genuineness of the transactions. There has to be explanation for the deposits in the accounts of share applicants and their source. There must be some positive evidence to show the nature and source of the resources of the share subscriber himself and therefore it is necessary for him to come before the Assessing Officer and confirm his sources from which he subscribed to the capital. Merely filing a letter at the "*dak*" counter of the Assessing Officer, is not compliance with the direction of the Assessing Officer who had issued notice to the assessee to produce the principal officers of the subscribing companies.

43. In the case of ***Nova Promoters & Finlease (P) Ltd*** on 15th February, 2012 The High Court Of Delhi (assessment u/s 143(1)/147, reopened on the basis of letter from investigation wing) held that the Tribunal ought to have seen that the *modus operandi* involves receipt by the entry providers of equivalent amount of cash from the assessee. The fact that the companies which subscribed to the shares were borne on the file of the ROC is a neutral fact. Every company incorporated under the Companies Act, 1956 has to comply with statutory formalities. That these companies were complying with such formalities does not add any credibility or evidentiary value. Section 68 permits the Assessing Officer to add the credit appearing in the books of account of the assesse, if the latter offers no explanation regarding the nature and source of the credit or the explanation offered is not satisfactory. In the judgment, the judgment of *Lovely Exports (2009) 319 ITR 0005* and the earlier number of judgments of the same High Court were also considered.

It is general economic principle that the Investments made to a country promote the Growth in the country. However, when the investments are not genuine in nature, it will have a counter-effect on the economy of the country. Hence, it is very essential to have stringent provisions in order to protect the economy of the country. Section 68 of the Income-tax Act, 1961 does well in this regard.

The Satisfaction of the Assessing Officer is mandated in order to escape from the liability. Furthermore, a reasonable burden of proof is laid on the assessee in order to escape from the punishments under the section well defined through various pronouncement of the Judiciary. Thus it can be concluded that a fair checks and balances are provided under the Section. While we have discussed various precedences under the provision, it is important to note that the application of provision depends on the facts and circumstances of each case.

Section 68 of the Income-tax Act, 1961 is a weapon in the hands of the assessing authorities, if they found any cash credit entries in the books of the assessee without having the supporting evidences. From the decisions of the various High Courts and of Supreme Court, it may be concluded that merely the PAN or the Certificate of Incorporation of the investor companies is not the sufficient proof but apart from this the relevant evidences like banks statements, presence of the investors if called/summoned, income tax returns, board resolution of share applicants etc may also be produced so as to avoid any additions of share application money as undisclosed income and bear the burden of tax.

It may be kept in mind that after introduction of the proviso to section 68 w.e.f 1.4.2013, if credit appears in the books of the company by way of share application money, share capital, share premium or any other amount by whatever name called the company has not only to prove the nature but has to prove the source of such sum. Therefore, not only the credit is to be proved but the source of such credit has also to be proved. Whether the word "*source*" will include source of source and whether the Assessing Officer can go beyond the source of source and proceed to third, fourth or fifth layer will again be a question to be decided by the Courts .But the proviso, though added w.e.f. 1.4.2013 yet the same being procedural will apply to all pending proceedings.

44. With due respect to the tax department's stand on invoking Section 68 to tax the difference in technical aspect of valuation, the aforesaid discussion fortifies the fact that Section 68 can be invoked only in situation wherein credits have been found in the books of an assessee which remains unexplained as to the nature and source of such funds. Section 68 cannot be invoked in a situation where there is a difference in the technical valuation of shares between the issue price and price computed in accordance with the rules, the exclusive domain for taxability of which is provided under Section 56(2)(viib) that too w.e.f. April 1, 2013. Furthermore, Section 68 also cannot be invoked in cases of genuine issue of shares by a company to joint venture partners or financial investors i.e. private equity, venture capital funds etc

So far as section 68 is concerned there are now numerous decisions of Hon'ble Tribunals and High Courts clearly hold that when such amounts are found credited in the books of accounts in the names of persons whose identity, genuineness and creditworthiness cannot be explained by the assessee to the satisfaction of the Assessing Officer then such sum so credited can be charged to Income Tax as income of the assessee of that previous year. But the decision of Hon'ble Supreme Court in case of *Lovely Export* came to the rescue of operators which were in a position to introduce unaccounted or black money in the modus operandi as illustrated above. By making amendment in the proviso of this section now it will be almost impossible to introduce unaccounted money in this manner. In a way it is a very welcome amendment as it is to curb introduction of black money in the guise of companies share capital. In view of this now every company in which public are not substantially interested shall have to maintain and in turn produce before the Income tax authorities the genuineness and creditworthiness besides the identity of the investors/ shareholders in share capital. It shall be the duty of a Chartered Accountant also to ensure that such kind of unscrupulous practice of introduction of black money in the guise of share capital is not allowed to be slipped through. The Government is aware of almost parallel economy of black money and has its limitation to control and curb. The citizens are aware that the tax rate and structure is quite moderate in India and therefore, it is the duty of Chartered Accountants to join the hands and perceive that as a professional activist we all must try to stop such kind of abuse or dubious tax planning. It is evenly our role like that of government/ Finance ministry, when we claim to be partners in Nation Building that circulation of Black Money is minimized and tax planning in the grab of avoidance done by giants through foreign companies and tax heaven entities are also controlled and checked.

RE-OPENING OF ASSESSMENTS ON THE GROUND OF ALLEGED BOGUS BOOKING OF SHARE TRADING LOSSES & LTCGS

1. Re-opening of assessments is a common feature of a fiscal statute and is one of the important tools to safeguard the leakage of revenue. The objective is laudable but it cannot be denied that there is, at times, abuse of power conferred by the statute. However, the legislature has provided in- built safeguard and there is catena of judicial decisions on the issue. As tax professionals, our duty is to make proper representation before the assessing officer as well as appellate authorities within the frame work of law. Representation before tax authorities becomes very important, because once the addition is confirmed by the Tribunal, the Assessing Officer will levy the concealment penalty, and once the penalty is confirmed the department may initiate prosecution proceedings. Therefore, it is imperative to make a proper representation before the Assessing Officer and where proceedings are not dropped and the A.O proceeds to frame a re-assessment order making additions, one is required to draft proper grounds of appeal and statement of facts before Commissioner (Appeals). Many a times, it is observed that assessees/ their representatives do not file or file inadequate and incomplete statement of facts and in the grounds of appeal even the ground challenging the re-opening proceedings is not taken.

It is the author's experience that in almost fifty percent of the cases, if not more, entire re-opening proceeding is held by the appellant authority- if not CIT(A) then the ITAT- to be bad in law. As a consequence, the additions made by the A.O in the re-assessment order fall to the ground.

So it is very important to appreciate the entire law relating to re-opening of assessments.

2. The law relating to re-opening as embodied in sec.147 has undergone tremendous change w.e.f 1.04.1989. Following basic change is noticeable in the amended provision.

2.1 Variation in the new provision :

(a) Sec.147(a) and Sec. 147(b) merged.

(b) New provision puts additional restriction in case scrutiny assessment is done.

(c) No requirement of "information" for re-opening. Merely, "reasons to belief" is sufficient.

2.2 Conditions precedent for re-opening :

Condition One : "Reason to Belief" about escapement of income

Condition Two : (a) Reason to belief occurred due to failure of the assessee to disclose material facts.

or

(b) Reasons to belief due to failure to file return of income.

2.3 Limitation Period for re-opening vis-à-vis Original Assessment :

(i) **Original assessment u/s. 143(1)/144 –**

Only condition one is to be satisfied for re-opening upto 6 yrs.

(ii) **Original assessment u/s. 143(3)/147 –**

(a) Re-opening upto 4 years (from the end of the relevant assessment year):

——— Only condition one is to be satisfied.

(b) Re-opening beyond 4 years (upto 6 years):

——— Both conditions are to be satisfied

Remarks : More stringent condition has been imposed for re-opening beyond 4 years where original assessment was framed u/s.143(3)/147.

3. Reasons to belief must be recorded :

(i) **Law :** As per sec. 148(2), the A.O. must record reasons to belief before issuing any notice u/s. 148.

(ii) **Consequence :** Non – recording will vitiate the entire assessment.

(iii) **Precedents :** (a) East West Commercial Co. Ltd. Vs. ITO 128 ITR 326 (Cal)

(b) CIT vs. Thakurlal 132 ITR 398 (MP)

(c) Shri Kabir Alam Halder, ITA No. 349 & 350/K/10, 'B' Bench: Kolkata, Order dated 15.12.2010

(d) Shri Bablu Saha, ITA No. 1326 (Kol) of 2007, 'E' Bench: Kolkata, Order dated 20.12.2007

4. FAQs

Questions :

(a) Whether "reasons" recorded by the A.O. itself can be challenged?

(b) Can the assessment order passed u/s.147 be quashed for improper recording of reasons?

Answers :

(a) Yes, the re-assessment proceedings can be challenged as bad in law either in –

(i) Writ proceedings before the jurisdictional High Court

or

(ii) the appellate fora viz., CIT(A) or ITAT.

(b) Improper recording of reasons by the A.O. will vitiate the entire re-assessment order.

5. Judicial Precedents on reasons recorded :

1. There should be direct nexus between the material coming to the notice of the A.O. and the formation of belief that there is escapement of income.

   - Lakhmani Mewal Das 103 ITR 437 (SC).

2. If there is no material or there is no rational and intelligent connection between the reasons and belief, so that, on such reasons, no one properly instructed on the facts and law could reasonably entertain the belief, the conclusion would be that the A.O. had no reasons to belief.

   - Ganga Saran & Sons (P) Ltd. vs. ITO 130 ITR 1 (SC)

3. (a) The words used in section 147 are "has reason to believe" and these words are stronger than the words "is satisfied".

   (b) The belief entertained by the ITO must not be arbitrary or irrational. It must be based on reasons which are relevant and material.

   - Ganga Saran & Sons (P) Ltd. vs. ITO 130 ITR 1 (SC)
   - ITO vs. Nawab Mir Barkat Ali Khan Bahadur 97 ITR 239 (SC)

4. The words of the statute are "reason to believe" and not "reason to suspect".

   - Bir Arjna Enterprises (P) Ltd. vs. ITO 204 ITR 258 (J&K).

5. The belief must be held in good faith, it cannot be merely a pretence.

   - Madhya Pradesh Industries (P) Ltd. vs. ITO 77 ITR 268 (SC)
   - Y. Rajan vs. ITO 77 ITR 839 (AP)
   - Abdul Majid vs. ITO 178 ITR 616 (MP)

6. The A.O. may act on direct or circumstantial evidence but not on mere suspicion, gossip or rumour.

   - Sheo Nath Singh vs. CIT 82 ITR 147 (SC)

6. Examples of Reasons recorded – Subject matter of challenge before the ITAT, Kolkata Benches :

(a) *"On the basis of tax evasion petition and departmental inspector's report, I had reason to believe that the assessee's taxable income for the A.Y.'s 1991-1992 to 1996 -1997 might have escaped assessment. In due obedience to the instruction of the higher authorities, notices u/s 148 were issued on 3.3.99 on served on 31.03.99".*

Shri Deb Kumar Ghosh vs. ITO, ITA Nos. 960 to 965 (Kol) of 2007, 'A' Bench, Kolkata, order dated 19.06.2007.

Finding of the ITAT- The Hon'ble Tribunal allowed the assessee's appeal holding that issuance of notice u/s 148 was not valid.

(b) *"An information received from DDIT (Inv.) unit IV (2) / Kol vide letter no. DDIT (Inv.) / Kol/ Unit IV (2) / 02-03 / 2482 dated 17.02.03, in respect of sale transaction of Rs. 5,01,800/- with Kartick Exports, a Mumbai based concern. This transaction is to be verified for its genuineness, therefore, it is reason to believe that there is an escapement of income. Hence, notice u/s 148 for the A.Y.: 1999-2000 is issued".*

Shri Nilesh H. Avalani vs. ITO, ITA No. 2317/Kol/2005, 'D' Bench, Kolkata, order dated 31.03.2006.

Finding of the ITAT- The Hon'ble Tribunal allowed the assessee's appeal holding that the proceedings initiated u/s 148 was liable to be cancelled.

(c) *"During this year, the assessee has introduced new capital of Rs. 8,50,000/- for which no evidence was filed and TAR is in silent in this respect. The assessee has paid huge amount of LIC premium and made drawings during this year. New investment in Land and Building was made of Rs. 1,45,200/ -. No paper filed with ROI. Considering the facts and circumstances of the case, I have reasons to believe that the income has escaped due to failure to file full details on the part of the assessee".*

Subhendu Chakraborty vs. ACIT, ITA No. 61&62/Kol/2010, 'B' Bench, Kolkata, order dated 24.09.2010.

Finding of the ITAT- The Hon'ble Tribunal allowed the assessee's appeal holding that the action of the A.O. to initiate reassessment proceedings was not valid.

(d) *"The assessee had shown opening capital of Rs. 2,80,080/- as on 31.03.1997 trying to explain the accumulation of capital by filing accounts of earlier sixteen years but without filing any evidence of income having earned by him in these years. The amount of Rs. 2,80,080/- was therefore, unexplained, and as such, notice u/s 148 was issued".*

Gunadhar Sadhukhan vs. ITO, ITA No. 947/Kol/2006, 'D' Bench, Kolkata, order dated 17.07.2006.

Finding of the ITAT- The Hon'ble Tribunal allowed the assessee's appeal holding that the reasons recorded by the A.O. were not at all worthy for reopening the proceeding.

(e) "*The department received a tax evasion petition that the assessee had not disclosed income from private practice. Some nursing homes were mentioned in the petition, where he was allegedly attending patients. In view of the above information, the A.O. has stated that he has reason to believe that the assessee's income had escaped assessment within the meaning of section 147 of the Act"*

Dr. Jaydip Biswas vs. Dy. CIT, ITA No. 1644/Kol/2008, 'B' Bench, Kolkata, order dated 07.11.2008.

Finding of the ITAT- The Hon'ble Tribunal allowed the assessee's appeal holding that the A.O. initiated reassessment proceedings merely on the basis of suspicion and not on the sufficient material before him.

7. Sample Grounds challenging the re-opening proceedings :

A. For that the reopening of assessment initiated u/s 147 of the Act is bad in law and the assessment framed in pursuance thereto is bad in the eye of law and liable to be quashed.

7.1 Suggested GOA for non-recording of "reasons to belief" and improper recording of reasons by the A.O.

A. For that the assessment order dated ——— framed u/s 143(3) / 147 is void and nullity in the eye of law as there are no valid recorded reasons to belief that income chargeable to tax has escaped assessment.

B. Without prejudice to the above ground, the recorded reasons are invalid and improper and as such, the assessment framed vide order dated ——— is bad in the eye of law.

8. Whether re-opening is possible on same facts disclosed in the original assessment proceedings u/s. 143(3)???

Answer :

- **Re-opening is not possible on mere change of opinion i.e., where material facts have been disclosed in the original assessment proceedings u/s. 143(3).**

  Normally, this benefit is available where re-opening is proposed after 4 years.

9. Case – Laws on 'Change of Opinion' :

(a) In Andhra Bank Ltd. vs. CIT 225 ITR 447 (SC), it was held that when there is no fresh fact available to the A.O. on the basis of which he is seeking to reopen the assessments, this appears to be a case of mere change of opinion. The principles enunciated in Kalyanji Mavji's case 102 ITR 287 cannot save the impugned action of the A.O.

(b) In Jindal Photofilms Ltd. vs. Dy. CIT 234 ITR 170 (Del.), the High Court opined that where nothing new has happened and there is no change in law, no new material came on record, no information has been received, in such circumstances, it can be said that it is a merely a fresh application of mind by the A.O. to the same set of facts and thus a case of mere change of opinion

(c) In Garden Silk Mills Ltd. vs. Dy. CIT 222 ITR 68 (Guj.), it was held that the reassessment by the new incumbent is not valid when there is no fresh fact but only a change of opinion. A mere change of opinion would not amount to escapement of income.

In the above case, the A.O. had applied his mind to the computation of income for the relevant A.Y.: 1993-94. There was nothing to indicate that the A.O. in consequence of fresh facts and information in his possession had reason to believe that income had escaped assessment. Under these circumstances, the Hon'ble High Court held that reassessment proceedings were not valid.

(d) In Mercury Travels Ltd. vs. Dy. CIT 258 ITR 533 (Cal.), it was held that where the primary facts were before the A.O. when he made assessments under sub-section (3) of section 143 and it was not open to him to invoke the provisions of section 147 of the said Act to reopen the assessments because he might have omitted to notice certain facts by oversight. For change of opinion, the provisions of section 147 of the said Act cannot be put to service.

(e) In CIT vs. Kelvinator of India Ltd. 256 ITR 11 (Del.)(FB), it was held that between the date of order of assessment and recording of reasoning, nothing new has happened. There was no change of law, no new material has come on record, no information has been received. It was merely a fresh application of mind by the same A.O. to the same set of facts which resulted into the conclusion. This was a case of mere change of opinion which does not provide jurisdiction to the A.O. to initiate proceedings u/s 147 of the Act.

(f) In CIT vs. Foramer France 264 ITR 566 (SC), it was held that the notices were bad as they were only on the basis of change of opinion and the law that an assessment could not be reopened on a change of opinion was the same before and after amendment by the Direct Tax laws (amendment) Act, 1987, of section 147. The Apex Court categorically held that reassessment on the basis of mere change of opinion is not valid.

(g) In ITO vs. Nawab Mir Barkat Ali Khan Bahadur 97 ITR 239 (SC), it was held that when the primary facts necessary for reassessment had been fully and truly disclosed to the A.O. , he was not entitled on change of opinion, to commence proceedings for reassessment under proviso to section 147 of the amended Act. Supreme Court observed interalia that having second thoughts on the same material did not warrant the initiation of proceedings u/s 147.

10. Whether theory of "change of opinion" can be applied where the intimation was issued u/s. 143(1)?

No. In CIT vs. Rajesh Jhaveri Stock Brokers (P) Ltd. 291 ITR 500 (SC), it was held that at the time of issue of Intimation u/s. 143(1), no opinion would have been formed , so no change of opinion is inferable.

11. Whether the assessee can claim the benefit of "change of opinion" in case of wrong claim by the assessee or mistake by the A.O.?

The ANSWER is not easy.

Let us consider some case studies.

But the following points have to be remembered-

(a) Whenever there is an escapement of income, it is due to-

(i) Wrong claim by the assessee or

(ii) Due to mistake by the A.O.

(b) "Change of Opinion" benefit can be taken when-

(i) Original assessment is u/s 143(3).

(ii) Assessment sought to b re-opened is beyond 4 years (normally).

(iii) There no failure by the assessee to disclose material facts i.e., material facts have been disclosed.

12. CASE STUDIES

In all these cases-

(a) Original assessment was framed u/s 143(3).

(b) Assessment sought to be re-opened was beyond four years.

To EXAMINE

Normally, it is to be seen-

Whether there was disclosure of material facts?

a) **Case 1**

The recorded reasons for reopening of the assessments for the assessment years in question are as under:

"Because of incorrect interpretation of accounts by the Assessing Officer the assessee got the benefit of loss of Rs. 34,40,715 for the assessment year 1992-93 which was carried forward to subsequent years .Since in the opinion of the then Assessing Officer the cases for the above assessment years were covered by Explanation 2 to section 147 which states that where an assessment has been made but income chargeable to tax has been underassessed, there is deemed escapement of income. Hence, action under section 147 is initiated".

It was held in *Amiya Sales and Industries and another V. Assistant Commissioner of Income-tax And Others 2005-(274)-ITR -0025 –CAL* that -

a) It has nowhere been recorded that there was failure or improper disclosure on the part of the assessee.

b) The recorded reasons do not speak of any omission or failure on the part of the assessee. Thus, admittedly there was no failure on the part of the assessee to disclose fully and truly all material facts in the assessments.

c) Incorrect interpretation of accounts by the Assessing Officer cannot confer jurisdiction on the Assessing Officer to issue notices under section 148 for reopening the assessments as sought to be made in the instant case."

b) Case 2

"Assessee is a State Government undertaking. Original assessment for the asst. yr. 1984-85 was completed under s.143(3) fixing a total income at Rs. 2,56,62,398. Assessee at that stage claimed deduction of penal interest levied by the Sales-tax Department for the belated payment of purchase-tax amounting to Rs. 63,18,000. Claim was initially allowed by the AO. Subsequently AO reopened the assessment by issuing notice dt. 13th Jan., 1994 under s.148 on the ground that the assessee was allowed deduction of Rs. 63,18,000 being interest for belated payment of tax even though the expenditure related to earlier years.

It was also noticed that from the annual report and the accounts for the year 1983-84 at p. 13 item 17 Department was aware of the fact that there was default in repayment of purchase-tax by the assessee."

It was held in ***Commissioner Of Income Tax V. Kerala State Cashew Development Corporation Ltd.2006-(286)-ITR -0553 –KER*** that the assessee did not disclose the fact that liability to pay penal interest arose not in the relevant assessment year but in the earlier assessment years. Consequently assessee did not disclose material fact necessary for assessment of the assessee for the asst. yr. 1984-85. In other words, assessee had failed to disclose this material fact. Consequently, AO was justified in issuing notice under s.148 after the expiry of four years from the end of the assessment year.

One of the purposes of s. 147 appears to us to be to ensure that a party cannot get away by wilfully making a false or untrue statement at the time of original assessment and when that falsity comes to notice, to turn around and say 'you accepted my lie, now your hands are tied and you can do nothing'. It would be a traversity of justice to allow the assessee that latitude."

c) Case 3

"ITO allowing terminal allowance under s. 32(1)(iii) on erroneous .At the time of original assessment, the particulars for claiming terminal allowance were placed before the ITO. In earlier year also such allowance was allowed on erroneous basis."

It was held in ***Commissioner Of Income Tax V. Sundaram Industries Ltd 1998-(231)-ITR -0761 - MAD*** that if the materials on record were already considered by him while making the assessment, if he found that such an order was not correct, at a later stage, he cannot reopen the assessment by reassessing the same materials, which were already considered by him in the original assessment

d) Case 4

"The assessee is a limited foreign company incorporated under the Municipal laws of Panama. The company was assessable under the deeming provisions of sec.44BB at the rate of 10 p.c. of gross receipts. The company offered one per cent. of the gross receipts of the work done outside India. The same was erroneously assessed @ 1 p.c."

In the case of ***Mcdermott International Inc. V. Additional Commissioner Of Income-tax And Another. 2003-(259)-ITR -0138 –UTTARNLI*** it was held that there was no failure on the part of the assessee as envisaged by the proviso to section 147 or in any manner by suppression or omission, he took advantage and escaped the assessment.

Section 147 does not cast any duty upon the assessee to instruct the Income-tax Officer on what legal inference the A.O should draw.

e) Case 5

Reasons Recorded are as under-

"During the assessment proceedings, furnished details of all the expenses incurred by it including the import expenses comprising interest, foreign exchange fluctuation, rebate and discount, LC charges/ bank charges and hundi charges. Taking in view of the nature of the income declared by the assessee, I am of the view that the aforesaid expenses have no relevance with any of the sources of the income and these expenses have been wrongly claimed and allowed expenses to the extent of Rs. 7,27,000 to earn dividend income of Rs. 1,58,58,710 which has been claimed as exempt under S.10(33) of IT Act. These expenses of Rs. 7,27,000 which were to be disallowed have not been disallowed in the assessment completed"

It was held in ***Consolidated Photo & Finvest Ltd. V. Assistant Commissioner Of Income Tax 2006-(281)-ITR -0394 -DEL*** that it is inconsequential whether or not the material necessary for taking a decision was available to the AO either generally or in the form of a reply to the questionnaire served upon the assessee. What is important is whether the AO had based on the material available to him taken a view. If he had not done so, the proposed reopening cannot be assailed on the ground that the same is based only on a change of opinion.

f) Case 6

"The assessee claimed higher rate of depreciation. But the facts like the nature of the plant and machinery in respect of which depreciation is claimed, the value thereof at the beginning of the assessment year and at the end of the year, addition or disposal, if any were disclosed in the statement filed."

It was held in ***Deputy Commissioner Of Income Tax V. Pala Marketing Co-operative Society Ltd. & Anr. 2000-(243)-ITR -0499 -KER*** **that** –

Does the duty, however, extend beyond the full and truthful disclosure of all primary facts? In our opinion, the answer to this question must be in the negative. Once all the primary facts are before the assessing authority, he requires no further assistance by way of disclosure. It is for him to decide what inferences of facts can be reasonably drawn and what legal inferences have ultimately to be drawn.

13. Sample GOA before CIT(A) on "Change of Opinion"

1. For that the re-opening of assessment for the A.Y.:…… is bad in law and beyond jurisdiction inasmuch as the assessment has been re-opened on mere "Change of Opinion" on the same set of facts.

2. For that the re-assessment order framed as on……. is barred by limitation inasmuch as the re-opening of the assessment has been made beyond four years and there was no failure on the part of the assessee to disclose material facts in the original assessment framed u/s 143(3) on……..

3. For that, in view of the above-mentioned grounds, the entire re-assessment order dated……..is bad and is liable to be quashed.

14. Ratio of GKN Drive Shaft

(a) The Supreme Court in the above-mentioned case reported in 259 ITR 19 held that the A.O. is bound to furnish the reasons recorded within a reasonable time, if the assessee asks for the same.

(b) The assessee can ask for the reasons recorded only after he files a return pursuant to a notice for re-opening u/s 148.

(c) Once "reasons" are furnished, the assessee can file his objections, if any

(d) The A.O. is bound to deal with the objections in a speaking order before proceeding with the assessment.

15. Fallout of GKN Driveshafts' case

(i) No writ remedy is available merely on the issue of notice u/s 148.

(ii) The procedure before the A.O. has been streamlined to reduce the burden of the High Courts in writ matters.

(iii) Writ can be entertained on jurisdiction if no satisfactory order on assessee's objections has been filed by the A.O.

(iv) In Fisher-Xomox Sanmar Ltd. vs. ACIT 271 ITR 393 (Mad.), the High Court followed Supreme Court decision in DKN Driveshafts in directing the A.O. to deal with the assessee's objection by passing a speaking order.

(v) In some cases, the High Courts have entertained writs even before the assessee filed objections before the A.O., where it was felt that a notice u/s 148 was prima facie illegal.

CASE-LAWS

Ajanta Pharma Ltd. Vs. ACIT 267 ITR 200 (Bom.)

Garden Finance Ltd. Vs. ACIT 268 ITR 48 (Guj.)

16. Can the assessee challenge the validity of re-opening before CIT(A) even if the procedure prescribed by the GKN Driveshafts' case is not followed?

Yes, after re-assessment order is passed, the assessee can challenge re-opening proceedings alongwith the grounds relating to the merit of the case before CIT(A).

Important:

The assessee should immediately apply and obtain "reasons recorded" by the A.O. after filing the appeal.

17. Some Important Issues Decided In Courts

(a) Assessment once opened, the jurisdiction of A.O. to assess other items not subject-matter of re-opening is enlarged.

CIT vs. Best wood Industries 331 ITR 63 (Ker.) (FB)

(b) The language of amended section 147 is-

"assess or reassess such income and also any other income chargeable to tax which has escaped assessment **and** which comes to his notice subsequently in the course of proceedings u/s 147".

From the above, it follows that both the conditions are cumulative.

Where, no addition is made on the item being subject-matter of re-opening, new items cannot be added.

CIT vs. Jet Airways (I) Ltd. 331 ITR 236 (Bom.)

(c) **Re-Opening is not a substitute for rectification**

Where assessment of a partner required modification as a result of assessment made on the firm, such modification is to be done by resorting to rectification proceedings u/s 155 and not by re-opening of assessments.

CIT vs. Shyama Charan Gupta 261 ITR 362 (All.)

(d) Not valid when original assessment is pending

Held in **CIT vs. Rajendra G. Shah 247 ITR 772 (Bom.)**

Even where the original assessment is pending before the A.O. due to set- aside order by the appellate authority, it is not open to the A.O. to issue fresh notice.

- **Jhunjhunwala Vanaspati Ltd. vs. ACIT 266 ITR 664 (All.)**
- **CIT vs. Ranchhodas Karsondas 36 ITR 569 (SC)**
- **CIT vs. S. Raman Chettiar 55 ITR 630 (SC)**

(e) Re-assessment done within four years from the end of the relevant A.Y.- re-opening quashed on the ground of "change of opinion"

(i) It was held in the case of **German Remedies Ltd. v. DCIT and Ors.(2006) 285 ITR 26 (Bom.)** that-

"Though the power conferred under Section 147 of the Income tax Act, 1961, for reopening a concluded assessment is very wide, it cannot be exercised mechanically or arbitrarily. The expression 'reason to believe that any income chargeable to tax has escaped assessment' means entertaining a reasonable belief that a particular income went unnoticed by the Assessing Officer and hence escaped assessment. Even after the introduction of the concept of deemed escapement of income by Explanation 2 to Section 147 of the Act with effect from April 1, 1989, the belief that the income has escaped assessment entertained by the Assessing Officer must be a prudent belief and not mere change of opinion. ***The assessment order passed after detailed discussion cannot be reopened within a period of four years.***

(ii) The above decision was followed by the ITAT in the case of **Glaxo Smith Kline Pharmaceuticals ltd. [(2011)10 ITR (Trib.) 631.**

(iii) It was held in the case of CIT v. Kelvinator of India Ltd. 320 ITR 561 (SC) that-

"even after 1-4-1989, the concept of change of opinion is not removed. Resultantly, reopening of assessment can be made provided there is some tangible material with the AO to form a belief that income chargeable to tax has escaped assessment. Reopening of an assessment within a period of four years from the end of relevant assessment year after 1-4-1989 could be made as long as the same is not based on mere change of opinion".

(iv) **In** the case of **Gujarat Power Corporation Ltd. (Guj) [(2013) 350 ITR 266], Gujarat High Court** allowed the benefit of change of opinion to the assessee, where reassessment was sought to done within four years.

18. It is learnt that a large no. of cases have been re-opened/ are in the process of being re-opened on the ground of alleged bogus losses/ LTCGs booked in order to allegedly reduce the taxable income or allegedly enhance the tax-free income by routing the money back in the books in the form of LTCGs. The brokers concerned have been searched/surveyed by the investigation wing and their statements have been recorded wherein they have allegedly accepted having been indulged into providing entries to book bogus losses/gains. List of the so-called beneficiary clients has also been obtained. There is a large-scale re-opening of such cases to tax such income.

It is important to analyse the legal position of the validity of re-opening of assessments.

Fortunately, the issue is not new and there are plethora of decisions available bang on the point. Some of such decisions are analysed hereunder which will help the professional brothers/sisters in proper handling of the re-opened cases before the revenue / appellate authorities by following the procedure explained in the preceding paras.

19. In a case before the Hon'ble Delhi High Court in the case of **CIT vs Shri Atul Jain 299 ITR 383**, the facts were that the assessee had purchased shares of M/s Globe Commercials Ltd. through M/s Maheshwari Sons, stock and share broker. Subsequently, these shares were sold at a much higher value through another broker Satish Kumar Goel, proprietor of R.K. Aggarwal & Co. The assessee had disclosed long term capital gains arising from the transaction. According to the A.O, some intra-departmental information was received by the Assessing Officer to the effect that the assessee had taken a bogus entry of long term capital gain after paying the equivalent amount in cash together with premium for the accommodation entry to Satish Kumar Goel. This information was received from the Deputy Director of Income Tax (Investigation), Gurgaon. Based on the information received, the Assessing Officer took action to issue a notice under Section 148 of the Income Tax Act, 1961 to the assessee. The A.O proceeded to record 'reasons to belief' as under-

"As per information received from DDIT (Inv.) Gurgaon, the assessed had taken bogus entry of capital gains Rs. 1,08,845/- on 22.6.96 (A.Y. 1997-98) by paying cash along with some premium and taking cheque of same amount."

According to the Hon'ble High Court, the reasons recorded were vague and not proper. The Assessing Officer had not even recorded his satisfaction about the correctness or otherwise of the information. The Assessing Officer did not verify the correctness of the information received by him but merely accepted the truth of the vague information in a mechanical manner. Therefore, the entire re-assessment order was quashed with the following observations-

"Looked at in the light of the decisions placed before us and the law laid down therein, it is necessary to appreciate the information available with the Assessing Officer in the present case. The only information is that the assessee had taken a bogus entry of capital gains by paying cash along with some premium for taking a cheque of that amount. The information does not indicate the source of the capital gains (which in this case are shares). We do not know which shares have been transacted and with whom has the transaction taken place. There are absolutely no details available and the information supplied is extremely scanty and vague. In so far as the basis for the reasons is concerned, even this is absent. The Assessing Officer did not verify the correctness of the information received by him but merely accepted the truth of the vague information in a mechanical manner. The Assessing Officer has not even recorded his satisfaction about the correctness or otherwise of the information or his satisfaction that a case has been made out for issuing a notice under Section 148 of the Act. Read in this light, what has been recorded by the Assessing Officer as his "reasons to believe" is nothing more than a report given by him to the Commissioner of Income Tax. As held by the Supreme Court in Chhugamal Rajpal, the submission of a report is not the same as recording of reasons to believe for issuing a notice. The Assessing Officer has clearly substituted form for substance and, therefore, the action of the Respondent falls foul of the law laid down by the Supreme Court in Chhugamal Rajpal which is clearly applicable to the facts of these appeals."

20. In another case before the same High Court in the case of CIT vs. vs. SFIL STOCK BROKING LTD. reported in 325 ITR 285 the facts were similar. In this case before the High Court the facts were that the assessee in his original return of income filed on 30th Nov., 1998 had shown a long-term capital gain of Rs. 40,953. The said return was processed under s. 143(1) on 22nd March, 2002. Subsequently, by a letter dt. 17th March, 2003, the Dy. Director of IT (Inv.) informed the AO of the assessee that during the course of investigation Shri Satish Goel, proprietor of M/s R.K. Aggarwal & Co. has stated on oath that the transactions through bank account No. 003097, of Corporation Bank were only paper transactions in which the party was intending to take bills paid in cash and issue cheques/drafts showing the said amounts as sale of shares. **It was further informed that the he was neither a share broker nor a member of any stock exchange and that he was doing the work of giving entries. Further information was given that the entry of Rs. 20,70,000 in account No. 003097, dt. 28th Feb., 1998 and 1st March, 1998 was nothing but entry taken by paying cash.** Thereafter, on the basis of the aforesaid information, a notice under s. 148 of the said Act was issued by the AO to the assessee, which was allegedly the beneficiary of the bogus claim of long-term capital gain shown on sale/purchase of shares. Subsequently, the **reasons for issuance of the notice under s. 148** were provided to the assessee and the said reasons, as recorded, were as under :

"Information received from Dy. Director of IT (Inv), 107, Sushant Lok, Gurgaon vide his letter No. DDIT (Inv)/GGN/02-03/271, dt. 17th March, 2003 received in my office on 25th March, 2003, that one of my assessees M/s SFIL Stock Broking Ltd. had made bogus claim of long-term capital gains shown as earned on account of sale/purchase of shares taken through bank account No. CA-3097, Corporation Bank, Karol Bagh, New Delhi in the name of R.K. Aggarwal & Co. by obtaining entries for Rs. 6,00,000, Rs. 7,00,000 and Rs. 7,70,000 on 28th Feb., 1998, 28th Feb., 1998 and 1st March, 1998 respectively. He has directed the AO to get notices issued under section 148. Subsequently, I have been directed by the Addl. CITR8, New Delhi vide his letter No. Addl. CIT R8/2002-03/572, dt. 26th Aug., 2003 to initiate proceedings under s. 148 in respect of cases pertaining to this ward. Thus, I have sufficient information in my possession to issue notice under s. 148 in the case of M/s SFIL Stock Broking Ltd. on the basis of reasons recorded as above."

The Hon'ble High Court had once again no hesitation in holding the re-assessment order as invalid on the basis of improper reasons recorded i.e., without applying his mind to the information and without independently arriving at a belief . It was held as under-

"It is clear that the AO referred to the information and the two directions as 'reasons' on the basis of which he was proceeding to issue notice under s. 148. We are afraid that these cannot be the reasons for proceeding under s. 147/148 of the said Act. The first part is only an information and the second and the third parts of the beginning para of the so-called reasons are mere directions. From the so-called reasons, it is not at all discernible as to whether the AO had applied his mind to the information and independently arrived at a belief that, on the basis of the material which he had before him, income had escaped assessment. Consequently, we find that the Tribunal has arrived at the correct conclusion on facts. The law is well settled. There is no substantial question of law which arises for our consideration. The appeal (of the revenue) is dismissed."

21. In yet another case which was before the Hon'ble Gujarat High Court in the case of **Varshaben Sanatbhai Patel vs. ITO (unreported decision)** , where the re-opening was done on the basis of alleged information in regard to alleged bogus purchases made the assessee, the reasons recorded were as under-

"On verification of details available on records, it is noticed that assessee has made Bogus Purchase of Rs.30,65,639/-, during the financial year 2008-09 i.e. A.Y. 2009-10. By claiming bogus purchases in the trading and P & L A/c as an expenses, the assessee has shown less profit to the extent of the amount of Bogus Purchases."

The re-opening proceedings were challenged before the High Court by filing a writ petition. The court again quashed the re-opening by giving the following reasoning-

"The Assessing Officer has stated that on verification of the details available on record, it has been noticed that the assessee has made bogus purchases; however, no specific averments are made as regards which details available on record reflected such bogus purchases. It is evident that the Assessing Officer for the purpose of reopening the assessment has placed reliance upon the material from an external source which does not form part of the record. However, the said aspect is not reflected in the reasons recorded. On behalf of the Assessing Officer, the learned counsel is not in a

position to point out any material on the record on the basis of which the Assessing Officer could have formed such belief. What is now sought to be stated by way of the order rejecting the objections as well as the affidavit-in-reply filed in response to the averments made in the petitions is that the formation of belief is based upon the information which is received from the DGIT (Inv.), Mumbai. It is settled legal position as held by a catena of decisions that the substratum for formation of belief that income liable to tax has escaped assessment has to form part of the reasons recorded. In the present case, the substratum for formation of belief, as indicated in the order rejecting the objections as well as the affidavit-in-reply, is the information given by the DGIT (Inv.), Mumbai, which got no relation with the reasons recorded, which are stated to be based upon the material available on record. Under the circumstances, the Assessing Officer, on the basis of the material on record, could not have formed belief that there was any escapement of income chargeable to tax so as to validly assume jurisdiction under section 147 of the Act. As held by the Supreme Court in a catena of decisions, the reasons recorded cannot be supplemented in the affidavit or by the order rejecting the objections. The material, on the basis of which, the belief that income chargeable to tax has escaped assessment has been formed, has to find place in the reasons itself.

In the aforesaid premises, the formation of belief that income has escaped assessment not being based upon record, it is evident that the substratum for reopening the assessment is not laid in the reasons recorded, but on material extraneous thereto. Under the circumstances, the basic requirement for assumption of jurisdiction under section 147 of the Act for reopening the assessment is not satisfied in the present case. The impugned notice under section 148 of the Act, therefore, cannot be sustained."

22. In a recent case before the Delhi Tribunal in the case of **Unique Metal Industries vs. ITO , Order dtd.** October 28, 2015 ,reopening once again was solely on the basis of information received from another AO that the assessee has booked bogus bills but without independent application of mind of the A.O of the assessee to the information.

The Tribunal had no hesitation in holding as under-

"The above observation of the Assessing Officer also shows that it was letter dated 20.12.2013 received by him from the ACIT on the basis of which the Assessing Officer could make a view that the purchase bills provided by these persons or their family members is nothing but bogus purchase bills. At the time of recording of the reasons the Assessing Officer apparently was not having any idea about the nature of the transactions entered into by the assessee. In the reasons recorded there is no mention about the nature of the transactions. As per provision of section 147 an assessment can be reopened if the Assessing Officer has reasons to believe that any income chargeable to tax has escaped assessment. The reasons to believe has to be that of the Assessing Officer and further there have to be application of mind by the Assessing Officer. The Assessing Officer was also not aware of the nature of the accommodation entries. In the reasons recorded he has simply mentioned the names of the party and the amount and nowhere has stated the nature of such entry. This also shows that the Assessing Officer has made no effort to look into the return of the assessee which was available with him. This fact gets further supported from the sheet appended to the reasons and quoted on page 4 of the assessment order whereby against Item no. 7, whether the assessment is proposed to be made for the first time, the Assessing Officer has stated 'Yes', and in Colunm no. 7(a), whether any voluntary return had already been filed and in Colunm no. 8 (b), date of filing the said return 'NA' has been stated. Thus this is a clear case of non-application of mind by the Assessing Officer. It may also be relevant that on page 2 of the assessment order, the Assessing Officer himself has stated that in this case the return of income for the year under consideration was filed with this ward on 27.09.2006. These facts clearly demonstrate that the return was with the same ward and at the time of recording of the reasons for reopening the assessment, the Assessing Officer has not looked at the return and in a mechanical way, on receipt of the letter from the CIT, the assessment has been reopened. It is a settled position of law that there must be material for formation of a belief that income has escaped assessment. Further reasons referred to must disclose process of reasoning by which the Assessing Officer holds reason to believe. There must be nexus between such material and belief. Further and most importantly the reasons referred to must show application of mind by the Assessing Officer. It is also a settled law that the validity of the initiation of the reassessment proceeding is to be judged with reference to the material available with the Assessing Officer at the point of time of the issue of notice under section 147.

In the present case, as is evident from the assessment order, the Assessing Officer was having nothing except the list provided by the CIT, Central-2, New Delhi about the list of accommodation entries. Beyond that he was not having the copies of the statement of any of these persons, He was not having copy of the assessment orders and other details or document which would have enabled the Assessing Officer to apply his mind and form a belief that income has escaped assessment. In fact this information was not with the Assessing Officer till fag end of the reassessment proceedings, a fact admitted by the Assessing Officer himself in the assessment order. Consequently, the reopening is not valid (Sarthak Securities Pvt. Ltd vs. ITO 329 ITR 110 (Del), Signature Hotels Pvt. Ltd 338 ITR 51 (Del) & CIT vs. SFIL Stockbroking Co 325 ITR 285 (Del) followed)"

23. From the above analysis, it is crystal clear that the courts are strict as to the manner in which the " reasons to belief" of the A.O are required to be recorded. Deviation from the norms, costs the department heavily inasmuch as apparently good re-assessments done by the A.O get quashed provided the representation on behalf the assessee is made in a proper way by taking appropriate grounds at the appellate fora.

Note : Most of the unreported decisions of ITAT, Kolkata Benches referred to in this referencer relate to the cases represented by the author himself at ITAT. If any professional brother/ sister requires a copy of the same, a requisition may be sent at subash_sushma@yahoo.in. A scanned copy will be provided through mail.

ANALYSIS OF SEC 14A

1. Background :

By the Finance Act of 2001, Parliament enacted section 14A with retrospective effect from 1-4-1962 to amend the law by taking away the basis of the judgments of the Supreme Court in *Indian Bank Ltd.'s* case AIR 1965 SC 1473, *Maharashtra Sugar Mills Ltd.'s* case [1971] 82 ITR 452 and *Rajasthan State Warehousing Corpn.'s* case *CIT* [2000] 242 ITR 450[1]. As it was initially enacted, section 14A postulated that for the purpose of computing the total income under the Chapter, no deduction shall be allowed in respect of expenditure incurred by an assessee in relation to income which does not form part of the total income under the Act. The Memorandum explaining the provisions of the Finance Bill of 2001 provided the following rationale for the insertion of section 14A :

"Certain incomes are not includible while computing the total income as these are exempt under various provisions of the Act. There have been cases where deductions have been claimed in respect of such exempt income. This in effect means that the tax incentive given by way of exemptions to certain categories of income is being used to reduce also the tax payable on the non-exempt income by debiting the expenses incurred to earn the exempt income against taxable income. This is against the basic principles of taxation whereby only the net income, *i.e.,* gross income *minus* the expenditure is taxed. On the same analogy, the exemption is also in respect of the net income. Expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income.

It is proposed to insert a new section 14A so as to clarify the intention of the Legislature since the inception of the Income-tax Act, 1961, that no deduction shall be made in respect of any expenditure incurred by the assessee in relation to income which does not form part of the total income under the Income-tax Act.

The proposed amendment will take effect retrospectively from 1st April, 1962 and will accordingly, apply in relation to the assessment year 1962-63 and subsequent assessment years."

The basic object of section 14A is to disallow the direct and indirect expenditure incurred in relation to income which does not form part of the total income. In view of section 10(*33*) inserted by the Finance Act, 1997 with effect from 1-4-1998, incomes by way of dividends referred to in section 115-O are not includible in the total income. Section 14A inserted by Finance Act, 2001 directs disallowance of the expenditure incurred in relation to dividends referred to in section 115-O in certain cases.

The insertion of section 14A was curative and declaratory of the intent of the Parliament. The basic principle of taxation is that only net income, namely, gross income *minus* expenditure that is taxable. Expenses incurred can be allowed only to the extent that they are relatable to the earning of taxable income. However, assessees had claimed deductions in respect of income which was exempt under various provisions of the Act as a result of which the tax incentive given in respect of certain categories of income which were exempt was being utilized to reduce the tax payable on non-exempt income. This being contrary to legislative intent, section 14A was inserted in order to restore the legal position consistent with Parliamentary intent. Declaratory or curative amendments are construed to be retrospective because they authoritatively set forth the original legislative intent. Parliament placed the matter beyond doubt by legislating upon section 14A with retrospective effect from 1-4-1962. This was also amplified in CBDT Circular No. 14 of 2001.

Subsequently, the proviso was added by Finance Act 2002 with retrospective effect from 11.5.2001 which provided that this Section shall not empower the Assessing Officer (AO) either to reassess or pass an order enhancing the assessment or reducing the refund already made or otherwise increasing the liability of the assessee for any assessment year beginning on or before 1st day of April 2001.

Sub Sections 2 & 3 were inserted by Finance Act 2006 w.e.f. 1.4.2007. Sub Section (2) empowers the AO to determine the amount of expenditure incurred in relation to such income which does not form part of total income in accordance with the method as may be prescribed. Such power is to be exercised if the AO, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of the expenditure mentioned in sub Section (1). Sub Section (3) provides that provisions of sub Section (2) shall also apply where assessee claims that no expenditure had been incurred in relation to income not forming part of total income.

The circumstances in which the provisions of sub-sections (2) and (3) were introduced by an amendment have been adverted to in a circular of the CBDT dated 28-12-2006 - Circular 14 of 2006. The circular notes that in the existing provisions of section 14A no method for computing the expenditure incurred in relation to income which does not form part of the total income had been provided. As a result there was a considerable dispute between taxpayers and the revenue on the method of determining such expenditure. In this background, sub-section (2) was inserted so as to make it mandatory for the Assessing Officer to determine the amount of expenditure incurred in relation to income which does not form part of the total income in accordance with the method that may be prescribed. The circular, however, reiterates that the Assessing Officer has to follow the prescribed method if he is not satisfied with the correctness of the claim of the assessee having regard to the accounts of the assessee.

By virtue of the powers conferred under sub Section (2), Rule 8D was inserted by gazette notification dated 24.3.2008 which prescribes the method for computing the expenditure incurred in relation to the income not forming part of total income.

The consequence of the insertion of section 14A has been dealt with in a judgment of the Supreme Court in *CIT* v. *Walfort Share & Stock Brokers (P.) Ltd.* [2010] 192 Taxman 211. In *Walfort Share & Stock Brokers (P.) Ltd.'s* case , the assessee who was a member of the Stock Exchange, purchased units of a Mutual Fund on 24-3-2000 upon which it became entitled to a dividend of Rs. 1.82 crores. As a result of a payout of the dividend, the NAV of the mutual fund which was Rs. 17.23 per unit on 24-3-2000, stood reduced to Rs. 13.23 per unit on 27-3-2000. The assessee in the return claimed a deduction of Rs.1.82 crores as exempt from tax under section 10(*33*) but also claimed a set-off of the loss incurred on the sale of the units. This was disallowed by the Assessing Officer on the ground that the transaction was in the nature of dividend stripping. The disallowance was deleted by the Tribunal whose decision was confirmed by the High Court. The main issue before the Supreme Court was whether the loss on the sale of the units could be considered as expenditure in relation to earning dividend income exempt under section 10(*33*) and hence disallowable under section 14A. The revenue claimed that the differential between the purchase and the sale price of the units constituted expenditure incurred by the assessee for earning tax-free income and was liable to be disallowed under section 14A.

The Supreme Court explained the reason for the insertion of section 14A thus :

"The insertion of section 14A with retrospective effect is the serious attempt on the part of the Parliament not to allow deduction in respect of any expenditure incurred by the assessee in relation to income, which does not form part of the total income under the Act against the taxable income (*see* Circular No. 14 of 2001, dated 22-11-2001). In other words, section 14A clarifies that expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income. In many cases the nature of expenses incurred by the assessee may be relatable partly to the exempt income and partly to the taxable income. In the absence of section 14A, the expenditure incurred in respect of exempt income was being claimed against taxable income. The mandate of section 14A is clear. It desires to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and at the same time avail the tax incentive by way of exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. The basic reason for insertion of section 14A is that certain incomes are not includible while computing total income as these are exempt under certain provisions of the Act. In the past, there have been cases in which deduction has been sought in respect of such incomes which in effect would mean that tax incentives to certain incomes was being used to reduce the tax payable on the non-exempt income by debiting the expenses, incurred to earn the exempt income, against taxable income. The basic principle of taxation is to tax the net income, *i.e.,* gross income *minus* the expenditure. On the same analogy the exemption is also in respect of net income. Expenses allowed can only be in respect of earning of taxable income. This is the purport of section 14A."

The following principles would emerge from section 14A and the decision in *Walfort Share & Stock Brokers (P.) Ltd.'s* case (*supra*) :—

(*a*) The mandate of section 14A is to prevent claims for deduction of expenditure in relation to income which does not form part of the total income of the assessee;

(*b*) Section 14A(1) is enacted to ensure that only expenses incurred in respect of earning taxable income are allowed;

(*c*) The principle of apportionment of expenses is widened by section 14A to include even the apportionment of expenditure between taxable and non-taxable income of an indivisible business;

(*d*) The basic principle of taxation is to tax net income. This principle applies even for the purposes of section 14A and expenses towards non-taxable income must be excluded;

(*e*) Once a proximate cause for disallowance is established—which is the relationship of the expenditure with income which does not form part of the total income - a disallowance has to be effected. All expenditure incurred in relation to income which does not form part of the total income under the provisions of the Act has to be disallowed under section 14A. Income which does not form part of the total income is broadly adverted to as exempt income as an abbreviated appellation.

2. Issue 1 :Whether Rule 8D of Income Tax Rules, 1962 applies to Assessment Year 2008-2009?

Section 295(4) of the Act provides as follows :

"(4) The power to make Rules conferred by this section shall include the power to give retrospective effect, from a date not earlier than the date of commencement of this Act, to the Rules or any of them and, unless the contrary is permitted (whether expressly or by necessary implication), no retrospective effect shall be given to any rule so as to prejudicially affect the interests of assessees."

Sub-section (4) empowers the rule-making authority to give retrospective effect to subordinate legislation. However, unless expressly or by necessary indication, a contrary provision is made, no retrospective effect is to be given to any rule so as to prejudicially affect the interests of the assessee.

Even in the absence of sub-sections (2) and (3) of section 14A and of rule 8D, the Assessing Officer was not precluded from making apportionment. Such an apportionment would have to be made in order to give effect to the substantive provisions of sub-section (1) of section 14A which provide that no deduction would be allowed in respect of expenditure incurred in relation to income which does not form part of the total income under the Act. Consequently, *de hors* the provisions of sub-sections (2) and (3) of section 14A and rule 8D, the Assessing Officer was entitled to determine by the application of a reasonable method what quantum of the expenditure incurred by the assessee would have to be disallowed on the ground that it was incurred in relation to the earning of income which does not form part of the total income under the Act. Undoubtedly, in determining what would constitute a reasonable method for effecting the disallowance, the Assessing Officer would have to give due regard to all the facts and circumstances of the case. The change which is brought about by the insertion of sub-sections (2) and (3) into section 14A by the Finance Act of 2006 with effect from 1-4-2007 is that in a situation where the Assessing Officer is not satisfied with the correctness of the claim of the assessee in regard to the expenditure incurred by it in relation to the non-taxable income, the Assessing Officer would have to follow the method which is prescribed by the Rules. The Rules were notified to come into force on 24-3-2008. It is a trite principle of law that the law which would apply to an assessment year is the law prevailing on the first day of April. Consequently, rule 8D which has been notified on 24-3-2008 would apply with effect from assessment year 2008-09.

The Bombay High Court in *Godrej & Boyce Mfg. Co.ltd. vs Deputy Comm of Income Tax reported in* [2010] 194 Taxman 203 has held that Rule 8D would apply with effect from assessment year 2008-09.

3. Issue 2 :Whether Rule 8D can be arbitrarily invoked by the Assessing Officer, when the Assessee has suo moto disallowed expenditure related to exempted income based on reasonable calculation?

Section 14A(2) prescribes a uniform method for determining the amount of expenditure incurred in relation to income which does not form part of the total income only in a situation where the Assessing Officer, having regard to the accounts of the assessee is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. It therefore merits emphasis that sub-section (2) of section 14A does not authorize or empower the Assessing Officer to apply the Rule 8D irrespective of the nature of the claim made by the assessee. The Assessing Officer has to first consider the correctness of the claim of the assessee having regard to the accounts of the assessee. The satisfaction of the Assessing Officer has to be objectively arrived at on the basis of those accounts and after considering all the relevant facts and circumstances. The application of Rule 8D arises in a situation where the claim made by the assessee in respect of expenditure which is relatable to the earning of income which does not form part of the total income under the Act is found to be incorrect. In such a situation a method had to be devised for apportioning the expenditure incurred by the assessee between what is incurred in relation to the earning of taxable income and that which is incurred in relation to the earning of non-taxable income. As a matter of fact, the memorandum explaining the provisions of the Finance Bill, 2006 and the CBDT circular dated 28-12-2006 state that since the existing provisions of section 14A did not provide a method of computing the expenditure incurred in relation to income which did not form part of the total income, there was a considerable dispute

between taxpayers and the department on the method of determining such expenditure. It was in this background that sub-section (2) was inserted so as to provide a uniform method applicable where the Assessing Officer is not satisfied with the correctness of the claim of the assessee. Sub-section (3) clarifies that the application of the method would be attracted even to a situation where the assessee has claimed that no expenditure at all was incurred in relation to the earning of non-taxable income.

Parliament has provided an adequate safeguard to the invocation of the power to determine the expenditure incurred in relation to the earning of non-taxable income by adoption of the prescribed method. The invocation of the power is made conditional on the objective satisfaction of the Assessing Officer in regard to the correctness of the claim of the assessee, having regard to the accounts of the assessee. When a statute postulates the satisfaction of the Assessing Officer "Courts will not readily defer to the conclusiveness of an executive authority's opinion as to the existence of a matter of law or fact upon which the validity of the exercise of the power is predicated". - *M.A. Rasheed* v. *State of Kerala* AIR 1974 SC 2249 (at para 7 page 2252). A decision by the Assessing Officer has to be arrived at in good faith on relevant considerations. The Assessing Officer must furnish to the assessee a reasonable opportunity to show cause on the correctness of the claim made by him. In the event that the Assessing Officer is not satisfied with the correctness of the claim made by the assessee, he must record reasons for his conclusion. These safeguards which are implicit in the requirements of fairness and fair procedure under Article 14 must be observed by the Assessing Officer when he arrives at his satisfaction under sub-section (2) of section 14A.

Sub-rule (1) of rule 8D has also incorporated the essential requirements of sub-section (2) of section 14A before the Assessing Officer proceeds to apply the method prescribed under sub-rule (2).

Reference is invited to the following judicial pronouncements :

a) Auchtel Products Ltd Vs ACIT [2012] 52 SOT 39 (Mumbai)(Uro)
(Assessment year 2008-09)

In this case the assessee earned certain exempt income without offering any amount disallowable under section 14A - Assessee's claim was that it had not spent any amount for earning exempt income - Assessing Officer without rendering any correctness of assessee's claim, proposed to make disallowance by applying Rule 8D. The Tribunal held that in order to make any disallowance under section 14A, firstly it is necessary to examine assessee's claim of having incurred some expenditure or no expenditure in relation to exempt income and, if Assessing Officer gets satisfied with same, then there is no need to compute disallowance as per rule 8D of 1962 Rules However, if Assessing Officer is not satisfied with correctness of claim of assessee in respect of such expenditure or no expenditure having been incurred in relation to exempt income, than mandate of rule 8D will operate

b) Relaxo Footwears Ltd.*v.*Additional Commissioner of Income-tax, Range-15, New Delhi [2012] 18 taxmann.com 333 (Delhi)
(Assessment year 2008-09)

Assessee had made certain investments, income wherefrom was exempt . Assessing Officer disallowed expenditure incurred for earning said income under section 14A. Assessee claimed that no expenditure had been incurred for earning exempt income.Commissioner (Appeals), however, upheld order of Assessing Officer on assumption that whenever exempt income is earning, there will be some expenditure incurred in relation thereto. The Tribunal held that such an assumption by Commissioner (Appeals) could not form basis for making disallowance under rule 8D.

The Assessing Officer should have considered the claim of the assessee that no expenditure has been incurred in relation to earning the exempt income. If the claim was not found to be in consonance with the facts on record, it could have been rejected and disallowance could have been made as per rule 8D. However, it is found that the Assessing Officer has not considered the claim of the assessee at all and he has straightway embarked upon computing disallowance under rule 8D. The Commissioner (Appeals) made an assumption that whenever exempt income is earned there will be some expenditure incurred in relation thereto. Such presumption cannot form the basis for making disallowance under rule 8D.

c) Balarampur Chini Mills Ltd. *v.*Deputy Commissioner of Income-tax [2012] 20 taxmann.com 117 (Kol.)
(Assessment year 2008-09)

The assessee earned dividend income and claimed exemption.. It incurred certain amount as expenditure relating to earning of exempt dividend income and this was disallowed *suo motu* by the assessee in

view of certificate of its statutory auditors. The Assessing Officer noted that the assessee company had not computed the disallowance in accordance with rule 8D of the Income-tax Rules and, accordingly, by invoking rule 8D(*ii*), made disallowance. The disallowance consisted of interest expenditure.

The Tribunal held, that the computation so made by the assessee was certified by its statutory auditors and this fact had been recorded by the Assessing Officer as well as Commissioner (Appeals). None of lower authorities had pointed out any defect in the correctness of the assessee's claim of expenditure as certified by its auditors. The assessee had borrowed money primarily for its main business activities of manufacture and sale of sugar, industrial alcohol, fertilizer, generation and distribution of power etc. and no part of borrowed money had any direct link or nexus with the investments made by the assessee-company, which had yielded tax-free dividend income. There was no linkage or nexus between the funds borrowed by assessee and the impugned investments, hence, no interest expenditure could be disallowed by mechanically applying the provisions of rule 8D.

d) ACIT vs. EICHER LIMITED [2006] 101 TTJ 369 (DELHI)

It was held in the case that burden is on the Assessing Officer to establish a nexus of expenses incurred with the earning of exempt income, before making any disallowance under Section 14A.

e) ACIT vs. JINDAL SAW PIPES LIMITED [2008] 118 TTJ 228 (DELHI)

It has been very clear held in the case that only direct expenses incurred in earning exempt income would attract disallowance under Section 14A. It has also been held in this case that there must exist a nexus between expenditure incurred and exempted income.

f) CIT vs METALMAN AUTO P. LTD. [2011] 336 ITR 434 (P & H)

The disallowance u/s 14A of the Income Tax Act, 1961, requires a finding of incurrence of expenditure for earning the exempt income. In case no expenditure has been, the disallowance u/s 14A is not justified. In other words, there cannot be a presumption that certain expenditure is bound to be incurred for earning the exempt income.

g) YOGESH J. SHAH vs ACIT [2011] 46 SOT 183 (Mum.)(URO)/[2010] 8 taxmann.com 23 (Mum. – ITAT)
A.Y. – 2005-06

Where assessee claims that he has not incurred any expenditure for earning exempt income, applicability of provisions of Section 14A cannot be ruled out and it is for Assessing Officer to determine as to whether assessee has incurred any expenditure in relation to income which does not form part of total income and if so to quantify extent of disallowance.

h) CIT vs. HERO CYCLES LTD [2010] 323 ITR 518 (P&H)

The Hon'ble High Court held that :

(i) The contention of the revenue that directly or indirectly some expenditure is always incurred which must be disallowed u/s 14A cannot be accepted.

(ii) Disallowance u/s 14A requires a finding of incurring of expenditure. If it is found that for earning exempted income no expenditure has been incurred, disallowance u/s 14A cannot stand.

i) DCIT vs. Jindal Photo Ltd (ITAT Delhi) ITA no. 4539/Del./2010 Asst year 2007-08 dated dec 22, 2010

The Tribunal held that disallowance under Section 14A read with Rule 8D can be invoked only if the AO "having regard to the accounts of the assessee is not satisfied with the correctness of the claim of the assessee in respect of expenditure incurred" in relation to tax free income. However, the assessment order did not evince any such satisfaction of the AO regarding the correctness of the claim of the assessee. As such, Rule 8D was not appropriately applied by the AO. The AO merely made an ad hoc disallowance. The Onus was on the AO to establish that expenditure was incurred to earn tax-free income. This onus has not been discharged . S14A requires a clear finding of incurring of expenditure and no disallowance can be made on the basis of presumptions The burden is on the AO to establish nexus of expenses incurred with the earning of exempt income, before making any disallowance u/s u/s 14A There is no presumption that the assessee must have incurred expenditure to earn tax free income.

j) Godrej & Boyce Vs DCIT 328 ITR 81 (Bom)

The Hon'ble Bombay High Court held that :

(i) Section 14A was enacted by Parliament in order to overcome the judgments of the Supreme Court in the case of *Indian Bank Ltd., Maharashtra Sugar Mills Ltd.* and *Rajasthan State Warehousing Corpn.* in which it was held that in the case of a composite and indivisible business, which results in earning of taxable and non-taxable income, it is impermissible to apportion the expenditure between that which was laid out for the earning of taxable as opposed to non-taxable income;

(ii) The effect of section 14A is to widen the theory of the apportionment of expenditure. Prior to the enactment of section 14A where the business of an assessee was not a composite and indivisible business and the assessee earned both taxable and non-taxable income, the expenditure incurred on earning non-taxable income could not be allowed as a deduction as against the taxable income. As a result of the enactment of section 14A, no expenditure can be allowed as a deduction in relation to income which does not form part of the total income under the Act. Hence, even in the case of a composite and indivisible business, which results in the earning of taxable and non-taxable income, it would be necessary to apportion the expenditure incurred by the assessee. Only that part of the expenditure which is incurred in relation to income which forms part of the total income can be allowed. The expenditure incurred in relation to income which does not form part of the total income has to be disallowed;

(iii) From this it would follow that section 14A has implicit within it a notion of apportionment. The principle of apportionment which prior to the amendment of section 14A would not have applied to expenditure incurred in a composite and indivisible business which results in taxable and non-taxable income, must after the enactment of the provisions apply even to such a situation;

(iv) The expression "expenditure incurred" in section 14A refers to expenditure on rent, taxes, salaries, interest etc. in respect of which allowances are provided for;

(v) Sub-sections (2) and (3) of section 14A are intended to enforce and implement the provisions of sub-section (1). The object of sub-section (2) is to provide a uniformity of method where the Assessing Officer is, on the basis of the accounts of the assessee, not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under the Act;

(vi) Even in the absence of sub-section (2) of section 14A, the Assessing Officer would have to apportion the expenditure and to disallow the expenditure incurred by the assessee in relation to income which does not form part of the total income under the Act. The Assessing Officer would have to follow a reasonable method of apportioning the expenditure consistent with what the circumstances of the case would warrant and having regard to all the relevant facts and circumstances;

(vii) Consequent upon the insertion of sub-section (2), the disputes which had arisen between taxpayers and the revenue on the method of determining the expenditure to be disallowed, have been given a quietus by adopting a uniform method of determination;

(viii) Sub-section (2) of section 14A does not enable the Assessing Officer to apply the method prescribed by rule 8D without determining in the first instance the correctness of the claim of the assessee, having regard to the accounts of the assessee. Sub-section (2) of section 14A mandates that it is only when having regard to the accounts of the assessee, the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of expenditure incurred in relation to income which does not form part of the total income under the Act, that he can proceed to make a determination under the Rules;

(ix) The satisfaction envisaged by sub-section (2) of section 14A is an objective satisfaction that has to be arrived at by the Assessing Officer having regard to the accounts of the assessee. The safeguard introduced by sub-section (2) of section 14A for a fair and reasonable exercise of power by the Assessing Officer, conditioned as it is by the requirement of an objective satisfaction, must, therefore, be scrupulously observed. An objective satisfaction contemplates a notice to the assessee, an opportunity to the assessee to place on record all the relevant facts including his accounts and recording of reasons by the Assessing Officer in the event that he comes to the conclusion that he is not satisfied with the claim of the assessee.

k) REI Agro Ltd. vs. Deputy Commissioner of Income Tax [ITAT No. 1811/Kol/2012 dated 14/05/ 2013 A.Y. 2009-10]

The assessee earned dividend income of Rs. 1,65,924/- and claimed the same as exempt u/s. 10(34) of the Act. The Assessing Officer required the assessee to furnish the details of expenditure incurred for earning this dividend income. The assessee in reply stated that no expenditure has been incurred to earn this dividend income because no new investment was made during the year and no interest at all is paid on the investments made for earning this dividend income. Further, it was clarified by the assessee that no loans were taken for making this investment for earning this dividend income. The Assessing Officer was not convinced with the reply of the assessee and made disallowance simply by making calculation by applying Rule 8D of the I. T. Rules, 1962

i) Direct expenses : In the P&L A/c no item of expenditure is identified which can be directly attributable to earning of such income or making of the long term investments listed above. Therefore, this figure is adopted at NIL.

ii) Disallowance of Interest not invoked. Amount to be disallowed A*B/C = NIL

iii) Disallowance of ½% of average value of investment Rs.107,29,27,282/- * 0.5% = Rs.53,64,636/- Total disallowance u/s. 14A Rs.53,64,636/-"

The Assessing Officer did not bring on record anything which proves that there is any expenditure incurred towards earning of this dividend income. The assessee had own funds to cover up the entire investment of Rs.110,79,27,282/ as it had accumulated funds i.e. share capital and reserves surplus at Rs.602,22,55,755/-. No loans or borrowed funds were taken for making investment in shares.

The Tribunal held that no disallowance under section 14A is called for when the assessee has not incurred and claimed any expenditure for earning the exempt income. The Tribunal in coming to the conclusion relied upon the following decisions:

Maxopp Investment Ltd and Others v. CIT 247 CTR 162,
Justice Sam P Bharucha vs. Addl. CIT in ITA No.3889/Mum/2011 dated 25.07.2012,
Walfort Share & Stock Brokers Pvt. Ltd 326 ITR 1 (SC),
Godrej and Boyce Company Ltd vs. DCIT (328 ITR 81),
CIT vs. Hero Cycles Ltd 323 ITR 518 (P&H);

4. Issue 3 :Whether the disallowance under Section 14A read with Rule 8D, can exceed the amount of expenditure incurred by the assessee/ debited to Profit and Loss Account?

The Hon'ble Delhi Tribunal in Gillette Group India (P.) Ltd Vs ACIT reported in [2012] 22 taxmann.com 61 (Delhi) has held that disallowance under section 14A cannot exceed expenditure actually claimed by assessee.

In this case the total expenditure claimed by the assessee in the profit & loss account was only Rs. 49,04,028/- while the Assessing Officer disallowed Rs. 2,37,59,757/-.

The Tribunal held that the disallowance cannot exceed the expenditure actually claimed by the assessee and that the disallowance made by the Assessing Officer and sustained by the learned CIT(A) in excess of total expenditure debited to profit & loss account was unjustified. The disallowance was restricted to the extent of expenditure actually claimed by the assessee *i.e.* Rs. 49,04,028.

5. Issue 4 : Whether the Assessing Officer can disallow depreciation by invoking Section 14A to the extent it is attributable to exempted income?

In the following cases it has been held that depreciation is an allowance and not an expenditure and is therefore out of the ambit of Sec 14A-

a) Vishnu Anant Mahajan vs Acit Itat Ahmedabad Bench (Special Bench) 137 ITD 189 [2012] 22 taxmann.com 88)

The Tribunal held that Section 14A deals only with expenditure and not with any statutory allowance admissible to assessee. Depreciation being a statutory allowance under section 32, provisions of section 14A would not apply in respect of depreciation.

b) Hoshang D. Nanavati , Mumbai Vs. ACIT [I.T. Appeal No. 3567 (Mum.) of 2007, dated 18-3-2011] Assessment year: 2003-04

The assessee contended that disallowance under section 14A cannot be invoked in respect of depreciation relying on the decision of Hon'ble Supreme Court's the case of Nectar Beverages P. Ltd. v. Deputy Commissioner of Income-tax (314 ITR 314), wherein, Their Lordships have, inter alia, observed that "depreciation is neither a loss nor an expenditure nor a trading liability....". It is then pointed out in terms of the provisions of section 14A, what can be disallowed is only "an expenditure incurred by the assessee in relation to an income which does not form part of the total income under this Act". It is thus pleaded that since depreciation is not an expenditure and since the disallowance under section 14A is confined to expenditure alone, no disallowance can be made in respect of depreciation.

The Tribunal held that the disallowance under section 14A cannot indeed cover depreciation inasmuch as what can be disallowed under section 14A is only expenditure incurred by the assessee and not allowance admissible to him. Hon'ble Supreme Court in the case of Nectar Beverages P. Ltd (supra) have clearly noted the distinction between an expenditure and allowance and the same principle and held that the expression 'expenditure' will not include allowances such as depreciation allowance. This principle, which was applied by Their Lordships in respect of taxability under section 41(1), applies to the facts situation before us as well. Depreciation is admittedly in the nature of allowance and, therefore, it cannot be subject matter of disallowance under section 14A, which must remain confined to expenditure incurred by the assessee.

6. Issue 5 :Whether the provisions of Section 14A apply to stock-in-trade?

In the following cases , it has been held that Sec 14A does not apply to dealer in shares-

a) CIT-vs- Smt. Leena Ramchandran (ITA No. 1784 of 2009—order dated14.6.2010) (Kerala High Court)

The assessee was engaged in the business of trading in goods. In A.Y. 2001-02, it was found that assessee paid interest of Rs.17,44,310/- on monies borrowed for the purpose of acquiring such shares. It was also found that assessee had received the dividend of Rs.3 lakhs only. The case of assessee was that the said Company was engaged in the business of leasing of goods and the assessee had sold such goods to the said Company. It was contended that acquisition of controlling interest in that Company was in the business interest of assessee and therefore no disallowance could be made. The AO was of the view that the provisions of Section 14A were attracted since dividend income did not form part of total income. Accordingly, the entire interest paid by assessee was disallowed. The CIT (A) confirmed the assessment. On further appeal, the Tribunal, following the decision of the Apex court in the case of **S.A.Builders Ltd** 288 ITR 1, substantially allowed the claim of assessee by reducing the disallowance to Rs.2 lakhs.

On appeal by the revenue before the High Court, it was noted that except the dividend income, no other benefit was derived by the assessee from the Company for the business carried on by her. Further, it was noted that the entire borrowed funds were utilized for acquiring the shares of that Company. Hence, the entire amount of interest was disallowable u/s 14A. However, it is pertinent to note the observations of their lordships **"In our view, assessee would be entitled to deduction u/s 36(1)(iii) of the Act on borrowed funds utilized for the acquisition of shares only if shares are held as stock in trade which arises only if the assessee is engaged in trading in shares. So far as acquisition of shares in the form of investment and only benefit assessee derived is dividend income which is not assessable under the Act, the disallowance u/s 14A is squarely attracted and the assessing officer, in our view, rightly disallowed the claim."**

b) CCI LTD. v. JCIT (KAR.), ITA NO. 359 OF 2011 dated 28/02/2012

The Hon'ble Karnataka High Court held that :

(i) When no expenditure is incurred by the assessee in earning the dividend income, no notional expenditure could be deducted from the said income. It is not the case of the assessee retaining any shares so as to have the benefit of dividend. 63% of the shares, which were purchased, are sold and the income derived therefrom is offered to tax as business income. The remaining 37% of the shares are retained. It is those unsold shares have yielded dividend, for which, the assessee has not incurred any expenditure at all.

(ii) Though the dividend income is exempt from payment of tax, if any expenditure is incurred in earning the said income, the said expenditure also cannot be deducted. But in this case, when the assessee has not retained shares with the intention of earning dividend income and the dividend income is incidental to his business of sale of shares, which remained unsold by the assessee, it cannot be said that the expenditure incurred in acquiring the shares has to be apportioned to the extent of dividend income and that should be disallowed from deductions.

c) Cheminvest Ltd-vs- Income Tax Officer 124 TTJ 577 (Del)(SB)

The Tribunal held stated that the borrowed money had been utilized in purchase of shares held both as investment as well as stock-in- trade. As the monies borrowed had been utilized for purchase of shares held, the interest paid on so borrowed monies was allowable against the income from dividend income either as incurred for making or earning dividend income on such shares or as incurred wholly and exclusively for the purpose of business carried on by the assessee, if he dealt in such shares. It was so in both the situations, irrespective of whether or not there was any yield of dividend on the shares purchased. In other words, the interest incurred was relatable to earning of dividend on the shares purchased. The dividend income is now exempted from tax by virtue of section 10(34) and, therefore, as a consequence thereof, the interest paid on borrowed capital utilized in purchase of shares, being the expenditure incurred in relation to dividend income not forming part of the assessee's total income, cannot be allowed as a deduction. There is no chargeable income against which it can be allowed as a deduction. It can also not be allowed against any other taxable income inasmuch as the interest so paid is not relatable to the earning of taxable income

The only controversy before the special bench was whether disallowance u/s 14A could be made where no dividend is received in the year under consideration. In this case the assessee had borrowed monies for acquiring shares as a trader as well as as an investor but no dividend was received in the concerned year. The contention of assessee was that since no income forming part of total income was received, the question of making any disallowance did not arise. After hearing the parties, it was held that if the expenditure is incurred in relation to income which does not form part of total income, it has to suffer disallowance irrespective of the fact whether any income is earned by the assessee or not. Section 14A does not envisage any such exception.——When prior to introduction of Sec 14A, an expenditure both under Sections 36 and 57 was allowable to an assessee without such requirement of earning or receipt of income, such condition cannot be imported when it comes for disallowance of the same expenditure u/s 14A. In coming to this conclusion, the bench relied on the decision of the Hon'ble Supreme Court in the case of CIT vs Rajendra Prasad Moody 115 ITR 519 SC.

Recently Hon'ble Delhi High Court has overruled the Special Bench decision in the above-mentioned case of Cheminvest Ltd. and has held that disallowance u/s. 14A cannot be made if exempt income is not received or receivable during the relevant previous year. The said decision is reported in 378 ITR 33 (Del).

d) Deputy Commissioner of Income Tax vs. Gulshan Investments Co. Ltd. [ITAT No. 1809/Kol/ 2012 dated 11/03/2013 A.Y. 2008-09]

The Assessee was engaged in the business of share trading and had earned dividend income of Rs. 18,91,556/- thereon. The Assessee did not made any disallowance under section 14A in respect of "expenses relatable to the above exempt income". The Assessing Officer computed the disallowance under section 14A read with Rule 8D as follows:

i. Rs. 7,97,762/- relating to interest

ii. Rs. 13,47,552/- relating to ½% of average value of stock-in-trade

The Learned CIT(A) upheld the calculation produced by the Assessing Officer. Aggrieved by the stand so taken by the Assessing Officer, the Assessee carried the matter in appeal before the Tribunal and the following principles were established:

1. Rule 8D(2)(ii) and (iii) can only be applied in the situations in which shares are held as investments, and that this rule will not have any application when the shares are held as stock in trade. It is so for the elementary reason that one of the variables on the basis of which disallowance under rules 8D(2)(ii) and (iii) is to be computed is the value of "investments, income from which does not or shall not form part of total income", and, when there are no such investments, the rule cannot have any application.

2. When no amount can be computed in the light of the formula given in rule 8 D(ii) and (iii), no disallowance can be made under rule 8D (2)(ii) and (iii) either. As held by Hon'ble Supreme Court in the case of CIT v. B C Srinivas Shetty (128 ITR 294), when computation provisions fail, the charging provisions cannot be applied, and by the same logic, when the computation provisions under rule 8 D (2) (ii) and (iii) fail, disallowance under the said provisions cannot be made either as the said provision is rendered unworkable.

3. However, in such cases, the application of rule 8 D(2)(i) cannot be excluded, which refers to the "amount of expenditure directly relating to income which does not form part of total income". In other words, in a case where shares are held as stock in trade and not as investments, the disallowance even under rule 8D is restricted to the expenditure directly relatable to earning of exempt income. Consequently, while Section 14A will still apply in the cases whether shares are held as stock in trade or as investments, and that is precisely what a Special Bench of this Tribunal has held in the case of ITO v. Daga Capital Management Pvt. Ltd. (117 ITD SB 169), the disallowance to be made under section 14A read with rule 8D will be restricted to direct expenses incurred in the earning of dividend income.

4. As a corollary to the above legal position, so far as disallowance under section 14 A in a situation in which the exempt income yielding asset, such as shares in question, is held as stock in trade, and not as investment, the disallowance will be of related direct and indirect expenditure, whereas disallowance under rule 8D will be restricted to disallowance of only direct expenses. Revenue thus derives no advantage from invoking rule 8D in such cases; on the contrary, the scope of disallowance is only minimised in such a situation.

e) JCIT .v. Pilani Investment & Industries Corpn. Ltd (Kol.) (Trib.)

For AY 2008-09, the assessee, a dealer in shares, received dividend of Rs. 18.91 lakhs but did not offer any disallowance u/s 14A and Rule 8D on the ground that they were not applicable to shares held as stock-in-trade. The AO rejected the claim and computed the disallowance under Rule 8D at Rs. 21.45 lakhs. On appeal, the CIT (A) held that even if Rule 8D was not applicable to shares held as stock-intrade, a disallowance had still to be made u/s 14A and this was estimated at Rs. 1.89 lakhs. On appeal by the department to the Tribunal HELD dismissing the appeal:

Though s. 14A applies to shares held as stock-in-trade, Rule 8D (2) (ii) & (iii) cannot apply if the shares are held as stock-in-trade because one of the variables on the basis of which disallowance under rules 8D(2) (ii) & (iii) is to be computed is the value of "investments, income from which does not or shall not form part of total income". If there are no such "investments", the rule cannot have any application. When no amount can be computed under the formula given in rule 8 D(ii) and (iii), no disallowance can be made under rule 8D (2) (ii) & (iii) either. As held in CIT v B. C. Srinivas Shetty (1981) 128 ITR 294 (SC), when the computation provisions fail, the charging provisions cannot be applied, and by the same logic, when the computation provisions under rule 8 D (2) (ii) and (iii) fail, disallowance there under cannot be made either as the said provision is rendered unworkable. However, this does not exclude the application of rule 8 D(2) (i) which refers to the "amount of expenditure directly relating to income which does not form part of total income". Accordingly, in a case where shares are held as stock-in-trade and not as investments, the disallowance even under rule 8 D is restricted to the expenditure directly relatable to earning of exempt income. The result is that the scope of disallowance under Rule 8D is narrower than that of S.14A. (AY. 2008-09)

f) REI Agro Ltd. vs. Deputy Commissioner of Income Tax
[ITA No.1331 & 1423/Kol/2011 dated 19/06/2013 A.Y. 2008-09]

The assessee had investments in shares of Rs. 103 crores on which it earned tax-free dividends of Rs. 1.3 lakhs. The assessee claimed that though its borrowings had increased by Rs. 122 crores, the said investments were funded out of own funds like capital and profits. It claimed that no expenditure had been incurred to earn the dividends and no disallowance u/s 14A could be made. The Assessing Officer applied Rule 8D and computed the disallowance at Rs. 4 crore. On appeal by the assessee, the CIT(A) reduced the disallowance to Rs. 26 lakh. On cross appeals, the Tribunal held as under:

1. When the Assessing Officer does not accept the assessee's claim regarding the non-applicability/ quantum of disallowance u/s 14A, he has to record satisfaction on that issue. This satisfaction cannot be a plain satisfaction or a simple note. It has is to be done with regard to the accounts of the assessee. On facts, as there is no satisfaction by the Assessing Officer, no disallowance u/s 14A can be made (Balarampur Chini Mills 140 TTJ (Kol) 73 (included in file) followed);

2. Rule 8D(2)(ii) is a computation provision in respect of expenditure incurred by way of interest which is not directly attributable to any particular income or receipt. This clearly means that interest expenditure which is directly relatable to any particular income or receipt is not to be considered under rule 8D(2)(ii). The Assessing Officer has to show that the interest is not directly attributable to any particular income or receipt. In the assessee's case, the interest has been paid on loans taken from banks for business purpose. There is no allegation that the loan funds have been diverted for making investment in shares or for non-business purposes. The loans are for specific business purposes and no bank would permit the loan given for one purpose to be used for making any investment in shares. Also, the assessee has substantial capital & reserves. Accordingly, the interest on the loans cannot be included in Rule 8D(2)(ii);

3. Further, in Rule 8D(2)(ii), the words used in numerator B are "the average value of the investment, income from which does not form or shall not form part of the total income as appearing in the balance-sheet as on the first day and in the last day of the previous year". The Assessing Officer was wrong in taking taken into consideration the investment of Rs.103 crores made during the year which has not earned any dividend or exempt income. ***It is only the average of the value of the investment from which the income has been earned which is not falling within the part of the total income that is to be considered. Thus, it is not the total investment at the beginning of the year and at the end of the year, which is to be considered but it is the average of the value of investments which has given rise to the income which does not form part of the total income which is to be considered. The term "average of the value of investment" is used to take care of cases where there is the issue of dividend striping;***

4. Under Rule 8D(2)(iii), what is disallowable is an amount equal to ½ percentage of the average value of investment the income from which does not or shall not form part of the total income. Thus, under sub-clause (iii), what is disallowed is ½ percentage of the numerator B in rule 8D(2)(ii). This has to be calculated on the same lines as mentioned earlier in respect of Numerator B in rule 8D(2)(ii). Thus, not all investments become the subject-matter of consideration when computing disallowance u/s 14A read with rule 8D. The disallowance u/s 14A read with rule 8D is to be in relation to the income which does not form part of the total income and this can be done only by taking into consideration the investment which has given rise to this income which does not form part of the total income.

g) Deputy Commissioner of Income Tax vs. Ashish Jhunjhunwala [ITAT No. 1809/Kol/2012 dated 14/05/2013 A.Y. 2009-10]

The Assessee had earned dividend income of Rs. 32,43,231/- and claimed the same as exempt u/s. 10(34) of the Income Tax Act, 1961. The Assessing Officer required the Assessee to furnish the details of expenditure incurred for earning this dividend income. The assessee in reply stated that no expenditure has been incurred to earn this dividend income because no new investment was made during the year and no interest at all is paid on the investments made for earning this dividend income. Further, it was clarified by the Assessee that no loans were taken for making this investment for earning this dividend income. The Assessing Officer was not convinced with the reply of the Assessee and made disallowance of ½% of the average value of investments simply by making calculation by applying Rule 8D of the I. T. Rules, 1962. On appeal before the Tribunal the assesee relied upon the following judicial pronouncements:

J. K. Investors (Bombay) Ltd. Vs. ACIT in ITA No.7858/Mum/2011, AY 2008-09 dated 13.03.2013,
Maxopp Investment Ltd and Others v. CIT 247 CTR 162,
Walfort Share & Stock Brokers Pvt. Ltd 326 ITR 1 (SC),
Godrej and Boyce Company Ltd vs. DCIT (328 ITR 81),
CIT vs. Hero Cycles Ltd 323 ITR 518 (P&H),
Justice Sam P Bharucha vs. Addl. CIT in ITA No.3889/Mum/2011 dated 25.07.2012,
Relaxo Footwears Ltd, vs. Addl. CIT (2012) 50 SOT 102,
Priya Exhibitors (P) Ltd vs. ACIT (2012) 54 SOT 356;

The Tribunal held in favour of the assessee and the held as under:

1. It is imperative that the Assessing Officer can invoke Rule 8D only when he records satisfaction in regard to correctness of the claim of the assessee, having regard to the accounts of the assessee . The condition precedent for the Assessing Officer entering upon a determination of the amount of the expenditure incurred in relation to exempt income is that the Assessing Officer must record that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. While rejecting the claim of the assessee with regard to the expenditure or no expenditure, as the case may be, in relation to exempt income, the Assessing Officer would have to indicate cogent reasons for the same.

Therefore, it is all the more necessary that Assessing Officer has to examine the accounts of assessee first and then if he is not satisfied with the correctness of the claim, only he can invoke Rule 8D.

No such examination was made or satisfaction was recorded by Assessing Officer in this case. It was noticed that the Assessing Officer has not considered the claim of the assessee at all and he has straightway embarked upon computing disallowance under Rule 8D.

2. Disallowance under section 14A required finding of incurring of expenditure and where it was found that for earning exempted income no expenditure had been incurred, disallowance under section 14A could not stand.

In this case, the assessee itself disallowed the interest which is directly applicable, Demat charges and administrative expense on estimation. The Assessing Officer had not examined any expenditure claimed in P& L account so as to relate to exempt income, nor gave a finding that assessee claim is not correct for any reason. Rule 8D cannot be invoked directly without satisfying about the claims or otherwise. Consequently, the disallowance was not permissible.

7. Issue 6 :Whether in computing the Book Profit under Section 115JB, the amount of expenditure relating to any income to which Section 10 (other than Section 10(38)) applies, can be added back by resorting to Section 14A?

The provisions u/s 14A prescribes the specific method for computing the disallowance, in case, the AO is not satisfied with the correctness of the claim of the assessee u/s 14A. No such mechanism of computing the disallowance u/s 14A is prescribed while computing disallowance u/s 115JB. Attention is drawn to the following judicial pronouncements-

a) A.C.I.T., Gnr. Circle, Gandhinagar -Vs- Gujarat State Energy Generation Ltd. I.T.A. No. 1777/ Ahd./2009 : Assessment Year 2006-2007

Gujarat State Energy Generation Ltd. –Vs- A.C.I.T., Gnr. Circle, Gandhinagar
I.T.A. No. 2028/Ahd./2009 : Assessment Year 2006-2007

The Tribunal stated that the decision of Hon'ble Supreme Court in the case of Apollo Tyres **reported in 255 ITR 273**, is quite unambiguous. The powers of AO are limited and he cannot go beyond what is stated in the Section. Only such items which are specifically mentioned in the Explanation to section 115JB need to be excluded or included, as the case be, and nothing more can be brought in. Disallowance under Sec 14A do not feature in the Explanation. Otherwise, the disallowance u/ s.14A would be material in computation of the normal process of income

b) Geetanjali Trading Ltd. Vs ITO I.T.A. No. 5428/Mum/2007 Assessment Year: 2004-05.

The amount of disallowance u/s 14A as computed by the AO has to be reduced from the book profits in terms of sub-clause (I) to Explanation 1 to Section 115JB.

c) Indo Rama Synthetics(I.) Ltd v. Commissioner of Income-tax reported in (2011) 330 ITR 363(SC)

It is by now well settled that Section 115JB of the Act is a self contained Code. In this case , the Apex Court observed as under :

" Section 115JB is a self-contained code. It applies notwithstanding other provisions of the Act. There is no scope for any allowances or deductions under any other section from what is deemed to be total income of the company (assessee)."

d) Goetze (India) Ltd [32 SOT 101 (Del)]

The Hon'ble Delhi Tribunal held that under clause (f) of the Explanation to section 115JA, the amount of expenditure relatable to any income to which any of the provisions of Chapter III apply has to be added to the book profit. Under the provision contained in section 14A, no deduction is to be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act. Since the issue of expenditure related to dividend income, a matter falling under Chapter III, it was clear on perusal of these two provisions that they are similar in nature. Clause (f) uses the words 'expenditure relatable to any income', while section 14A uses the words 'expenditure incurred by the assessee in relation to income'. These words have the same meaning. Further, section 14A contains two more sub-sections, sub-section (2) and sub-section (3), which do not find a place in clause (f). Therefore,

insofar as computation of adjusted book profit is concerned, provisions of sub-section (2) and sub-section (3) of section 14A cannot be imported into clause (f) of the Explanation to section 115JA.

This decision has been overruled by the Delhi High Court by a decision dtd. 9.12.2013 [source: www.itatonline.org]

e) Quippo Telecom Infrastructure Ltd vs. ACIT (ITA No. 4931/Del/2010 dt: 29/06/2011) (ITAT Delhi)

The Tribunal held that the provision of Section 14A cannot be imported into while computing the book profit u/s 115JB of the Act inasmuch as clause (f) of Explanation to sec. 115JB refers to the amount debited to the profit & loss account which can be added back to the book profit while computing book profit u/s 115JB of the Act. In this connection, reliance can be placed upon the decision of ITAT Delhi Bench in the case of Goetze (India) Ltd. Vs. CIT (2009) 32 SOT 101 (Del), wherein it has been held that provisions of sub-sec. (2) & (3) of section 14A cannot be imported into clause (f) of the Explanation to sec. 115JA of the Act. Therefore no addition to the book profit shall be made on account of alleged expenditure incurred to earn exempt income while computing income u/s 115JB of the Act.

This decision has been impliedly overruled by the Delhi High Court by a decision dtd. 9.12.2013 in the case of Goetze (India) Ltd [source: www.itatonline.org]

f) The similar view has been taken in the following cases also –

(i) ***M/s. Pretoria Enclave Ltd. Vs. DCIT, ITA No. 108/K/2012, 'B' Bench, Order dated 21.06.2012*****. [ITAT Kolkata]**

(ii) ***Reliance Industrial Infrastructure Ltd. Vs. ACIT, ITA No. 60&70/Mum/2009, 'D' Bench, Order dated 05.04.13*****.[ITAT Mumbai]**

8. Issue 7 :Whether Section 14A will apply in situations in which the Assessee has invested in shares and securities but not derived any exempted income?

a) Quality Engineering & Software Technologies (P.) Ltd. Vs DCIT [2014] 52 taxmann.com 515 (Bangalore - Trib.)

In appellate proceedings before us, the learned A.R. of the assessee reiterated the submissions of the assessee made before the authorities below, that these investments have been made in the Group Companies and have not been made with the intention to earn income and that no income has been earned by the assessee on these investments during the year under consideration. Since no exempt income has been earned during the year the question of making any disallowance of any expenditure does not arise. In support of the aforesaid contentions, the learned Authorised Representative relied on several judicial decisions, including the following decisions of the Hon'ble High Courts:—

(i) CIT v Corrtech Energy (P.) Ltd. [2014] 223 Taxman 130/45 taxmann.com 116 (Guj.).

(ii) CIT v Shivam Motors (P.) Ltd. [IT Appeal No.88 of 2014 dated 5.5.2014]

The Tribunal deleted the addition made by the AO under Section 14A and held as under:

"5.5.1 We have heard the rival contentions and perused and carefully considered the material on record, including the various judicial decisions cited and placed reliance upon. As pointed out by both the Assessing Officer and the learned CIT (Appeals), the Special Bench of the Mumbai Tribunal in the case of Cheminvest Ltd. (supra) has held that the disallowance for expenditure incurred could be made even in the year in which exempt income has not been earned. In our considered view, this decision of the Special Bench of the Mumbai Tribunal has been impliedly overturned by several judgments in various cases by several High Courts; as will be brought out in the succeeding paragraphs of this order.

5.5.2 In the case of Shivam Motors (P.) Ltd. (supra), the Hon'ble Allahabad High Court, inter alia, considered the following substantial question of law:—

> ***"2. Whether on the facts and in the circumstances of the case and in law, the Income Tax Appellate Tribunal was justified in upholding the decision of CIT (Appeals) in deleting the disallowance of Rs.2,03,752 u/s. 14A ignoring the fact that there is difference of opinion of various courts on the view taken by the ITAT that in the absence of tax free income, no disallowance u/s. 14A is permissible."***

The Hon'ble High Court has answered the above question of law as under:—

"As regards the second question, section 14A of the Act provides that for the purposes of computing the total income under the Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Act. Hence, what section 14A provides is that if there is any income which does not form part of the income under the Act, the expenditure which is incurred for earning the income is not an allowable deduction. For the year in question, the finding of fact is that the assessee had not earned any tax free income. Hence, in the absence of any tax free income, the corresponding expenditure could not be worked out for disallowance. The view of the CIT (Appeals), which has been affirmed by the Tribunal, hence does not give rise to any substantial question of law. Hence, the deletion of the disallowance of Rs.2,03,752 made by the Assessing Officer was in order."

5.5.3 The Hon'ble Gujarat High Court in the case of Corrtech Energy (P.) Ltd. (supra) has adjudicated on this issue at para 3.2 thereof as under :—

> ***"3.2..... We have given our thoughtful consideration to the facts and the decision relied upon by the ld.AR. The Hon'ble Punjab & Haryana High Court in the case of CIT v. Winsome Textile Industries Ltd. [2009] 319 ITR 204 (Punj. & Har.) has held that in the present case, admittedly, the assessee did not make any claim for exemption. In such a situation, section 14A could have no application. In this case also, the assessee has not claimed any exempt income in this year. Therefore, respectfully following the judgment of Hon'ble High Court of Punjab & Haryana in the case of CIT v. Winsome Textile Industries Ltd. (supra), we hereby allow this ground and direct the A.O. to delete the addition. Therefore, ground NOs.1 to 1.2 raised by the assessee in its cross-objection is to be allowed."***

5.5.4 There are many other decisions of other Hon'ble High Courts as well, wherein it has been held that where the assessee has not earned any income exempt u/s. 10(38) of the Act, disallowance of expenditure u/s. 14A of the Act is not tenable. Respectfully following the above decisions (cited supra), we also hold that the disallowance of expenditure u/s. 14A of the Act is not tenable and therefore delete the disallowance of Rs.7,34,975 made by the Assessing Officer."

b) However It has been held in the following cases that Section 14A will apply where the assessee has invested in shares and securities for the pupose of earning tax free income but no income was earned during the year.

(i) Cheminvest Ltd-vs- Income Tax Officer 124 TTJ 577 (Del)(SB)
[now stands overruled by Delhi High Court 378 ITR 33 (Del)]

(ii) Technopak Advisors (P.) Ltd.*v.*Add CIT [2012] 18 taxmann.com 146 (TDelhi)

9. Issue 8 :Whether Section 14A can be applied to disallowance of expenditure in relation to share of profit from a partnership firm received by a person?

Share of profit from a firm is exempt under Section 10(2A) and accordingly proportionate expenditure is to be disallowed under Section 14A as held in Vishnu Anant Mahajan Vs ACIT [2012] 137 ITD 189(Ahemedabad)(SB)

10. Issue 9 :Whether Section 14A can apply to interest expenditure incurred by an Assessee in contributing capital to the partnership firm wherefrom the person receives interest as well?

In ACIT Vs Novel Enterprises [2012] 52 SOT 127/22 Taxmann.com 116 (Mumbai –Ttrib.) A.Y – 2005-06, assessee had raised interest bearing loan from 'R'. Said loan had been utilized by assessee for making loan/capital contribution to firm 'S' in which it was a partner .Assessee received interest income and profits from firm 'S' . According to AO interest expenditure incurred by assessee had resulted into taxable as well as tax free income and, hence, that portion of interest expenditure which related to share of profit was liable to be disallowed in terms of section 14A. Held that in partnership deed, nowhere stipulated that sharing of profit was dependent on contribution of funds. Accordingly, disallowance made by AO u/S 14A was deleted.

11. Issue 10 :Whether interest on borrowed capital incurred for acquisition of Investment in shares from which exempted income will be derived can be disallowed under Section 14A? Whether interest incurred on investments can be capitalized and added to the cost of Investments thereby avoiding Section 14A?

The basic principle of taxation is to tax the net income. On the same analogy, the exemption is also to be allowed on net basis i.e. gross receipts minus related expenses. Therefore, if any expenditure is directly related to exempted income, it can not be allowed to be set off against taxable profit. On the same analogy, in our opinion, if any expenditure is directly related to taxable income, it cannot be allowed to be set off against the exempted income merely because some incidental benefit has arisen towards exempted income. Whether expenditure relates to taxable income or exempted income would depend on the facts of each case. If investments income wherefrom is exempt is acquired out of borrowed funds , interest will be disallowed under Section 14A.

The Courts have held that unless nexus can be established between borrowings and investment, disallowance of interest cannot be made.

a) CIT-vs- Smt. Leena Ramchandran (ITA No. 1784 of 2009—order dated14.6.2010)

The Karnataka High Court held that the assessee would be entitled to deduction u/s 36(1)(iii) of the Act on borrowed funds utilized for the acquisition of shares only if shares are held as stock in trade which arises only if the assessee is engaged in trading in shares. So far as acquisition of shares in the form of investment and only benefit assessee derived is dividend income which is not assessable under the Act, the disallowance u/s 14A is squarely attracted.

b) BNP Paribas SA Vs DDIT (International Taxation) [2012] 23 taxmann.com 450 (Mum.) Assessment year 2002-03

Assessee had earned dividend income in shares of company 'L' and same was claimed to be exempt under section 10(33) - Assessee claimed that said investment was made from its own funds. On appeal, Commissioner (Appeals) held that said investment was made by assessee in shares in an earlier year and a finding was given that said investment was made by assessee out of its own funds. Therefore the Assessing Officer was not justified in estimating interest expenses incurred by assessee in relation to exempt income on pro-rata basis and in making disallowance invoking provisions of section 14A.

c) MARUTI UDYOG LIMITED vs. DEPUTY CIT [2005] 92 TTJ 987 (DELHI)

It has been, inter alia, held in the case that onus is on the Revenue to prove that interest paid by the assessee on borrowed funds related to the acquisition of shares yielding tax-free income.

d) DEPUTY CIT vs. MAHARASHTRA SEAMLESS LIMITED(I.T.A. NO. 4063 (DELHI) 2006) A.Y. – 2003-04

It was held in the case that for disallowance of interest on borrowed funds under Section 14A, the Assessing Officer has to establish a nexus between borrowed funds and tax-free investments.

e) DEPUTY CIT vs. B.S.E.S. LIMITED [2008] 113 TTJ 227 (MUM.)

It was held in the case that nothing was brought under the record to show any nexus between interest expenditure and tax free income. Therefore, no disallowance under section 14A was sustainable.

f) G.D. METSTEEL (P.) LTD. vs ACIT [2011] 47 SOT 62/12 taxmann.com 165 (Mumbai – Trib.) A.Y. – 2005-06

Investment made out of own funds will not be entitled to any addition u/s 14A merely because assessee subsequently borrowed funds for business use. It was also noted that investment was made from own funds in preceding years and no part of interest payment was attributable to those investments

g) CIT vs. HERO CYCLES LTD [2010] 323 ITR 518 (P&H)

The assessee had both owned funds and interest bearing funds and claimed that its owned funds has been used for investment in shares. Assessing Officer disallowed interest on proportionate basis under Section 14A. Held that since no nexus has been established by the revenue to show that interest bearing funds had been invested for purchase on investment, on a mere presumption 14A cannot be applied.

h) CIT vs. Reliance Utilities and Power Ltd. (2009) 313 ITR 340 (Bom.)

If there were funds available both interest free and overdraft and / or loans taken a presumption would arise that investment would be out of the interest free funds generated or available with the company, if the interest free funds were sufficient to meet the investments, presumption that the borrowed capital was used for purposes of business hence interest was deductible.

Recently, the Hon'ble Bombay High Court in the case of ***CIT vs. HDFC Bank Ltd 366 ITR 505*** following Reliance Utilities' case held that no disallowance can be made u/s. **14A on account of interest paid on borrowings if assessee's own funds and non-interest bearing funds exceeds investment in tax-free securities. It was further held that** there was no basis for deeming that the assessee had used borrowed funds for investment in tax free securities.

i) Voltas ltd vs ACIT 17 CPT 130 (ITAT Mumbai)

Where assessee has established that none of its loan funds were used for making investments in shares, no disallowance u/s14A for interest paid being notionally attributed to investment in shares was made.

j) DY CIT V. BECK INDIA LTD, 26 SOT 141 (MUM)

Where there is no evidence that the shares were purchased out of borrowed funds, there could be no disallowance under section 14A for interest paid on funds borrowed for other purposes. In this case the assessee claimed to have purchased the shares long time back.

It was held that since there was no investment during the year and assessee had sufficient own funds as well as borrowed funds and it was not proved that the purchase was out of borrowed funds ,interest could not be disallowed under section 14A.

k) Maruti Udyog Ltd. Vs DCIT 92 TTJ (Del.) 2003 [BCAJ]

The Tribunal noted that the language of S. 14A is of wide amplitude to include expenditure of every kind irrespective of the head under which it is claimed, which relates to income not forming part of total income. If dividend is exempt u/s.10(33), expenditure incurred for earning it will be disallowed. The objects of S. 14A, can be achieved by harmonious construction. So, if Revenue wants to disallow interest paid on borrowings, it has to discharge the burden of proving that borrowed funds were used for acquisition of shares that fetched dividend. But, where assessee had interest for funds overwhelmingly more than the amount of investments, then disallowance u/s.14A will not be tenable.

In the following cases it has been held that interest on investments can be capitalized and added to the cost of investments.

l) Smt. Neera Jain v. ACIT ITA No. 1861/Mum./2009

The assessee applied for 1,26,000 shares of Punjab National Bank. For this purpose she borrowed Rs.4 crores @ 15% p.a. for 15 days and paid interest of Rs.2,63,015. She was allotted 4,635 shares. The entire amount of interest of Rs.2,63,015 was capitalised as cost of shares allotted. Similarly, the assessee applied for 8,76,000 shares of NTPC Ltd. For this purpose she borrowed Rs.4.88 crores @ 17% p.a. for 17 days and paid interest of Rs.3,87,317. She was allotted 73,403 shares. The entire amount of interest of Rs.3,87,317 was capitalised as cost of shares allotted.

The assessee sold the shares allotted. While computing capital gains on sale of shares allotted the entire amount of interest capitalised was regarded as cost of acquisition and claimed as deduction.

The Assessing Officer (AO) disallowed the entire interest of Rs.6,50,330 (Rs.2,63,015 + Rs.3,87,317).

The Tribunal noted that there was no dispute that the entire loan was borrowed for the purpose of acquiring the shares of Punjab National Bank and NTPC and also that immediately after allotment of shares, money refunded by both the companies was refunded to the financiers. The Tribunal held that the fact that applied shares were not allotted in full will not deprive the assessee from claiming the entire interest paid as part of the cost of acquisition of the shares allotted, as money borrowed has direct nexus with acquisition of shares. The Tribunal directed the AO to treat the interest paid by the assessee to both the financiers as part of cost of acquisition of shares and allow the same as a deduction.

m) S. Balan alias Shanmugam Vs DCIT (2009) 120 ITD 469 (Pune) [BCAJ]

Interest can be added to the cost of investment in shares. The Tribunal observed that even if it is a situation where a capital asset is acquired out of borrowed funds having liability of interest, and since it has been capitalised as cost of asset in the books of account and never claimed as a revenue expenditure, then that too is towards enhancing cost of such capital asset and cannot be segregated from cost of acquisition. The appellant is entitled to deduct interest for the purposes of S. 48 of the Act.

Further, analysing S. 14A of the Act, the ITAT held that the issue is related to the transfer of the capital asset and not the revenue generated. A situation may arise that on transfer of a capital asset, the gain is taxable but not the incidental income, and if so, the expenditure having nexus with the cost of acquisition has to be taken into account for the computation of gain as prescribed u/s.48 of the act.

In response to the argument of the Revenue that since interest had a nexus to exempt income, the provisions of S. 14A should be applied, the Tribunal noted that the words 'in relation to income which does not form part of the total income under this Act' mean if an income does form part of the total income, then the related expenditure is out of the ambit of the applicability of S. 14A. The capital gain shown by the assessee had formed part of the total income of the assessee. Otherwise also, capital gain is not exempt income and without any ifs and buts, always being taxed in the hands of a taxpayer. Therefore, the Revenue authorities have proceeded on a wrong premise that the interest expenditure was in respect of an income which was exempt or did not form part of the total income.

The Tribunal, relying on the decisions in the following cases, held in favour of the assessee :

(a) *CIT v. Mithilesh Kumari,* (1973) 92 ITR 9 (Del.)

(b) *Addl. CIT v. K. S. Gupta,* (1979) 119 ITR 372 (AP)

(c) *CIT v. Maithreyi Pai,* (1984) 43 CTR 88 (Kar.)/ (1985) 152 ITR 247 (Kar.)

In case of interest incurred by assessee on acquisition of capital assets , there are various decisions which have upheld the view that such interest can be capitalized and added to the cost of the asset , if the same has otherwise not been claimed as a deduction.

CIT v. Sri Hariram Hotels (P.) Ltd. [2010] 325 ITR 136 (Karn.)
CIT v. Maitheryi Pai [1985] 152 ITR 247 (Karn)

CIT v. Mithlesh Kumari [1973] 92 ITR 9 (Delhi)
CIT v. K.S Gupta [1979] 119 ITR 372 (A.P)
Naozar Chenoy v. CIT [1998] 234 ITR 95 (A.P)

12. Issue 11: Investment which has not resulted in any income cannot be considered for disallowance under Section 14A read with Rule 8D(2)(i) of the Rules -

Bellwether Microfinance Fund Pvt. Ltd. v. ITO (ITA No. 1743/Hyd/2013)

Background

Recently, the Hyderabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Bellwether Microfinance Fund Pvt. Ltd. (the taxpayer) held that investment which has not resulted in any income during the year cannot be considered for disallowance under Section 14A of the Income-tax Act, 1961 (the Act) read with Rule 8D(2)(i) of the Income-tax Rules, 1962 (the Rules). However, while computing disallowance under Rule 8D(2)(iii), the average of the total investment of the taxpayer as appearing in the balance sheet (irrespective of whether it has yielded income or not) on the first day and last day of the year can be considered for the purpose of disallowance.

The Tribunal while distinguishing Rule 8D(2)(i) from Rule 8D(2)(iii) observed that the use of the words 'does not or shall not' in Rule 8D(2)(iii) connotes that income not only does not form part of the total income during the year but it also shall not form part of the total income at any time.

- Had it been the intention of the Rule framing authorities to disallow under Rule 8D(2)(i) expenditure relating to total value of investment or income which is not earned during the relevant previous year, then, they would have use time.

- Had it been the intention of the Rule framing authorities to disallow under Rule 8D(2)(i) expenditure relating to total value of investment or income which is not earned during the relevant previous year, then, they would have used the expression 'does not or shall not form part of total income' as appearing in Rule 8D(2)(iii) instead of words 'does not form part of total income'.

Facts of the case

- The taxpayer is a non-banking financing company engaged in the business of investing in microfinance companies in India.
- Subsequently, the taxpayer changed its business model by making investments in equity, mutual fund, and also advanced loans to microfinance institutions.
- During the year under consideration, the taxpayer entered into a fund management agreement with Caspian Advisors Pvt. Ltd. (CAPL), as per which the said company would render consultation services to the taxpayer in the matter of investment etc. as fund manager. In lieu of the services rendered, the fund manager was to be paid remuneration to the fund based services by the taxpayer. In the return of income, the taxpayer had disallowed certain expenditure out of the fund management fees claimed under Section 14A of the Act read with Rule 8D of the Rules. However, the Assessing Officer (AO) did not agree with the disallowance worked out by the taxpayer. Accordingly, the AO quantified the expenditure pertaining to exempt/taxable income for the purpose of disallowance under Section 14A of the Act.

Tribunal's ruling

- On perusal of Rule 8D of the Rules, it indicates that expenditure in relation to exempt income would be disallowed under Section 14A of the Act. However, the AO while working out disallowance under Rule 8D(2)(i) of the Rules had taken into consideration the total investment irrespective of the fact whether they have yielded income or not.
- The term total income has not been defined either under Section 14A or under Rule 8D of the Rules. Therefore, reference can be made to the definition of 'total income' as provided in Section 2(45) of the Act.
- Section 2(45) of the Act refers to Section 5 of the Act which envisages 'scope of total income'. Perusal of Section 5 of the Act, it indicates that 'total income' includes income from whatever source derived which is received or deemed to be received in India in the previous year by or on behalf of such person, or accrues or arises or is deemed to accrue or arises to him in India during such year, or accrues or arise to him outside India during such year.
- The expression of 'total income' referred to in Rule 8D(2)(i) cannot be in abstract. It must relate to a previous year income of which is sought to be assessed. Therefore, only expenditure directly relating to income which is earned either on receipt basis or on accrual basis, and which does not form part of total income of a particular assessment year, can be disallowed under Rule 8D(2)(i) of the Rules.
- Rule 8D(2)(i) does not refer to the investment made by the taxpayer. Therefore, the Tribunal referred Rule 8D(2)(iii) and observed that conjoint reading of clause (i) and clause (iii) of Rule 8D(2), indicates that there is a clear difference between them. Rule 8D(2)(i) provides for disallowance of expenditure directly relating to income which does not form part of the total income. However, Rule 8D(2)(iii) provides for disallowance of expenditure of the average value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the taxpayer on the first day and last day of the previous year. On perusal of Rule 8D(2)(i) of the Rules, it indicates that the disallowance of expenditure must relate to the income which does not form part of the total income of that year. Therefore, investment, which has not resulted in any income cannot be considered for the purpose of disallowance under Rule 8D(2)(i). However, while computing disallowance under Rule 8D(2)(iii), the average of the total investment of the taxpayer as appearing in the balance sheet on the first day and last day of the year irrespective of whether it has yielded income or not can be considered for the purpose of disallowance.
- The use of the words 'does not or shall not' in Rule 8D(2)(iii) connote that income not only does not form part of the total income during the year, but it also shall not form part of the total income at any time. Had it been the intention of the Rule framing authorities to disallow under Rule 8D(2)(i) expenditure relating to total value of investment or income which is not earned during the relevant previous year, then, they would have used the expression 'does not or shall not form part of total income' as appearing in Rule 8D(2)(iii) instead of the words 'does not form part of total income'.

- If that being the case, the AO cannot disallow expenditure relating to investment which has not yielded any exempt income under Rule 8D(2)(i) of the Rules. Accordingly, the Tribunal directed the AO to disallow the expenditure relating to investments resulting in income earned/accrued which does not form part of the total income of the impugned assessment year. However, so far as AO's computation of expenditure to be disallowed under Rule 8D(2)(iii) is concerned, the same was in conformity with Rule 8D(2)(iii), hence, do not call for any interference.

13. Issue 12: Interplay between section 14A and other provisions

13.1 Revision of assessment u/s 263

CIT v. *Hotz Industries Ltd.* [2014] 49 taxmann.com 267 (Del.) (HC)

Once inquiries were conducted and a decision was reached by the AO, it cannot be said that it was a case of no inquiry and in exercise of power u/s 263, the CIT must reach a finding that, finding of AO was erroneous, not because no inquiries were conducted, but because final finding was wrong and untenable.

Decisions in favour of the assessee

CIT v. *Galileo India (P) Ltd.* [2014] 220 Taxman 115 (Mag.) (Del.) (HC) – The CIT passed order u/s 263 and recorded that the AO should have conducted further inquiries and correct disallowance should have been made u/s 14A read with Rule 8D. Held, an order is not erroneous, unless the CIT holds and records reasons why it is erroneous [AY 2006-07].

DLF Ltd. v. *CIT* [2009] 27 SOT 22 (Del.) (Trib.) - There being no specific finding by CIT to the effect that any particular expenditure was incurred for earning dividend income exempt under s.10(33), he was not justified in his revisional jurisdiction under s. 263 in asking the AO to make enquiry and find out of common expenses, which could be disallowed under s. 14A on proportionate basis [AY 2002-03]. This decision is upheld in *CIT* v. *DLF Ltd.* [2013] 350 ITR 555 (Del.) (HC).

Similar view was taken in *CIT* v. *L and T Infrastructure Development Projects Ltd* [2013] 357 ITR 763 (Mad.) (HC).

Decisions in favour of the Revenue

CIT v. *RKBK Fiscal Services P Ltd* [2013] 358 ITR 228 (Cal.) (HC) - Revision of order u/s 263 on account of no disallowance being made by AO u/s 14A was valid.

CIT v. *Goetze (India) Ltd.* [2014] 361 ITR 505 (Del.) (HC) - Revision order u/s 263 was held justified as the AO made error in computing income u/s.115JA and also failed to apply s.14A [AY 2000-01 to 2001-02].

Jammu & Kashmir Bank Ltd. v. *ACIT* [2009] 118 ITD 146 (Amr.)(Trib.) - AO having allowed exemption under ss. 10(15), 10(23G) and 10(33) without even considering the applicability of s. 14A, his order was erroneous as also prejudicial to interests of Revenue, hence rightly set aside by CIT in exercise of revisional jurisdiction. The total investment for earning such income must be more than 300 crores. An enquiry and examination was required to be made by the AO at the time o f completing the assessment as regards disallowance under s. 14A [AY 2002-03].

13.2 Reassessment u/s 148

CIT v. *P.G. Foils Ltd.* [2013] 356 ITR 594 (Guj.) (HC) – The AO reopened assessment by issuing notice u/s 148 recording three reasons. Two of such reasons pertained to extent of earning s exempt from Income-tax, which Revenue contended should have been disallowed u/s 14A. The CIT(A) as well as the Tribunal held that both issues were examined by AO in original assessment. Held, CIT (A) noted that AO had raised several queries with respect to those issues. Thus, Tribunal correctly held that any attempt on part of AO to re-examine such issues would only amount to change of opinion [AY 2008-09].

CIT v. *Dhanalakhsmi Bank Ltd.* [2013] 357ITR448 (Ker.) (HC) – By virtue of proviso to s. 14A, there is no justification to make reassessment u/s 147 for any AY prior to AY 2001-02.

Reckitt Benckiser Healthcare India Ltd. v. *ACIT* [2013] 216 Taxman 209 (Guj.)(HC) – Since the entire issue pertaining to disallowance of expenditure under s. 14A was scrutinized by Assessing Officer during original assessment proceedings, reopening of assessment to make disallowance of such expenditure on basis of formula provided in rule 8D would amount to change of opinion, and hence, bad in law [AY 2007-08].

Similar issue was decided in favour of the assessee in *ACIT* v. *Sterling Infotech Ltd.* [2013] 59 SOT 19 (Chennai) (Trib.) (URO) [reopening beyond four years].

13.3 Computation of book profits u/s 115JB

CIT v. *Goetze (India) Ltd.* [2014] 361 ITR 505 (Del.) (HC), *Time Technoplast Ltd.* v. *Addtl. CIT*, ITA No. 8126, 7576/M/2011, dated 2/1/2014 (ITAT Mumbai), *Godrej Consumer Products Limited* v. *Addtl.CIT*[2014] 159 TTJ 21 (Mum.)(Trib.), *ITO* v. *RBK Share Broking (P) Ltd.* [2013] 60 SOT 61 (Mum.)(Trib.)(URO), *Dabur India Ltd.* v. *ACIT* [2013] 145 ITD 175 (Mum.) (Trib.) etc. - Amount of expenditure disallowable u/s 14A was to be added back while computing book profit under clause (f) of explanation (1) to section 115JB. The Bombay High Court has admitted an appeal on the issue whether disallowance u/s 14A is to be added back for the purpose of computing book profits u/s 115JB – *CIT* v. *Garware Wall Ropes Ltd.*, ITA No. 1327 of 2013dt. 26/11/2014.

13.4 Section 14A and section 10B

Sandoz P. Ltd. v. *DCIT* [2013] 145 ITD 551 (Mum.) (Trib.) - Provisions of section 14A are not attracted in the case of the unit suffering losses eligible for deduction u/s 10B and further the assessee is entitled to set off of loss of STP unit u/s 10B against other business income [AY 2008-09].

13.5 Penalty u/s 271(1)(c)

Sunash Investment Co. Ltd. v. *ACIT* [2007] 14 SOT 80 (Mum.) (Trib.) – When Assessee claimed deduction of interest on borrowed funds which were invested in the financing business as well as purchase of shares of group companies under *bona fide* belief that such interest was deductible in entirety in view of some judicial pronouncements, it cannot be said that the assessee is guilty of concealment or furnishing of inaccurate particulars of income. Held, penalty under s. 271(1)(c) was not leviable [AY 1998-99].

CIT v. *Liquid Investment and Trading Co.* [ITA 240/2009 dated 5/10/2010 – Delhi HC] -

Disallowance u/s 14A of the Act was a debatable issue. Also, High Court had admitted the appeal of the assessee on quantum. Hence, penalty was not leviable.

Skill Infrastructure Ltd. v. *ACIT* [2013] 157 TTJ 565 (Mum.)(Trib.) – Disallowance u/s 14A does not call for penalty.

14. Conclusion

In recent times, it is seen that injudicious invocation of these provisions has become a cause of serious harassment for tax payers resulting in increased litigation. While the purpose of introducing the provisions of section 14A was to ensure that net income is actually taxed and no expenditure incurred for earning exempt income is claimed as deduction from business income, the blanket application of this section read with Rule 8D often results in a situation wherein even expenditure incurred for earning taxable income is disallowed. It is not uncommon to see a notional/ estimated disallowance computed by the Assessing Officer exceeding the amount of exempt income by multifold times or the disallowance so computed exceeding the total expenditure of the assessee.

The purpose of introduction of sections 10(34), 10(35) and 10(38) was to promote investment into Indian companies (directly or *via* mutual funds) by exempting dividends and capital gains upon their sale in certain circumstances, However, considering the amount of disallowance u/s 14A that can follow the receipt of such exempt income, an assessee would only be constrained to observe that the Assessing Officer takes by one hand what the Legislature has given by the other. It is the need of the hour for the Legislature to step in and carry out necessary amendments to prevent misuse of the provisions of section 14A of the Act. While in cases where the Assessing Officer is able to demonstrate nexus of expenditure with non-taxable business of the assessee, the actual amount of such expenditure (irrespective of the amount) should be disallowed u/s 14A, in cases where Rule 8D is applied by the Assessing Officer for want of satisfaction with the correctness of the claim of the assessee as regards such expenditure, the introduction of the following proviso inRule 8D may curtail litigation in this regard:

"*Provided that wheresuch expenditure determined in accordance with sub-rule (2)exceeds the amount of income which does not form part of the total income under the Act, then, such excess shall be ignored.*"

However, on the contrary, CBDT by issuing a Circular No. 5 of 2014 dated 11.02.2014 has, in which it directed that disallowance under section 14A and Rule 8D be made in cases where the corresponding exempt income has not been earned during the financial year, increased litigation considerably.

LAW AND PROCEDURE REGARDING STAY OF DEMAND

1.0 Introduction

An assessee is deemed to be in default only if he does not pay the tax within the time and in the manner specified in the notice of demand or as permitted u/s. 220(3). Recovery of tax commences with notice of demand u/s. 156. Service of notice is imperative and failure to serve such a notice will not render an assessee as an '*assessee-in-default*' even though the assessee may have knowledge of the demand. [*Satya Pal Verma v. ITO 106 ITR 540 (All.); T. Lakshmikutty Amma v. Addl. Agri ITO 163 ITR 336 (Ker.*)] Also Where the notice does not mention the year to which the demand pertains, the recovery proceedings are invalid [*Duncan Stration & Co. Ltd. v. UOI & Others 183 ITR 204 (Bom*.)].

Any tax, interest, penalty, fine or any other sum payable by virtue of an order passed under the Income Tax Act as specified in the Notice of Demand issued u/s 156 of the Act has to be paid within 30 days of the service of the notice.

As per sec. 220(4) of the Act, on failure to pay the dues within time, the assessee is deemed to be "*an assessee in default*". The assessee in default is not only liable to pay interest as per sec. 220(2) but may also be subjected to penalty u/s 221(1) to the extent of the amount of tax in arrears. However, discretion has been provided to the assessing officer by sec. 220(6) for not treating the assessee in default provided an appeal has been preferred before the Commissioner of Income-tax(Appeals). But before exercising such discretion in favour of the assessee he is empowered to impose such conditions as he may think fit to impose in the circumstances of the case.

Exercise of discretion u/s 220(6)-how to be exercised:

Discretion conferred by the statute to the assessing officer u/s 220(6) is not absolute and unfettered. According to Maxwell on Interpretation of Statutes, 10th Edition, page 123.

"*According to his discretion*" means it has to be according to the rules of reason and justice, not private opinion, according to law and not humour, it is to be not arbitrary, vague and fanciful, but legal and regular, it is to be exercised not capriciously, but on judicial grounds and for substantial reasons. It must be exercised within the limits to which an honest man competent to the discharge of his office ought to confine himself and within the limits and for the objects intended by the Legislature.

Supreme Court is *Aeltemesh Rein v. Union of India*, *AIR 1988 SC 1768* has stated that every discretionary power vested even in the executive should be exercised in a just, reasonable and fair way. Coming specifically to the discretionary power conferred by section 220(6) on the Assessing officer, courts have held that such discretion is coupled with duty and if does not exercise it when the occasion called for it or if he exercises it in such a manner that it is not exercise of discretion at all, he can be compelled to discharge his duties.

[*Ladhuram Tapuria* v. B K Bagchi's case *(1951) 20 ITR 51(Cal)*; *Aluminium Corporation of India v. C. Balakrishnan & Ors.*'s case *(1959) 37 ITR 267 (Cal)* and *Vetcha Sreeramamurthy v. ITO*'s case *(1956) 30 ITR 252 (A.P.)*]

***Gouri Shankar Awasthi v. ITO & Ors. [1970] 78 ITR 784 (Cal.)*:** Stay of realisation cannot be granted simply because an appeal has been preferred.

Mere filing/ pendency of an appeal does not constitute an automatic stay.[*Paulsons Litho Works v. ITO (1994) 208 ITR 676 (Mad.)*]

Therefore, it is important for assessee's to take steps to prevent any coercive methods from being taken by the Department to recover the outstanding dues.

2.0 Relevant Instructions on the subject

2.1 Office Memorandum

F.No.404/72/93-ITCC

Government of India
Ministry of Finance
Central Board of Direct Taxes (CBDT)

New Delhi, Dated: 29th February, 2016

Sub: Partial modification of Instruction No. 1914 dated 21.03.1996 to provide for guidelines for stay of demand at the first appeal stage.

Instruction No. 1914 dated 21.03.1996 contains guidelines issued by the Board regarding procedure to be followed for recovery of outstanding demand, including procedure for grant of stay of demand.

2. *In part 'C'of the Instruction, it has been prescribed that a demand will be stayed only if there are valid reasons for doing so and that mere filing of an appeal against the assessment order will not be a sufficient reason to stay the recovery of demand. It has been further prescribed that while granting stay, the field officers may require the assessee to offer a suitable security (bank guarantee, etc.) and/ or require the assessee to pay a reasonable amount in lump sum or in installments.*

3. *It has been reported that the field authorities often insist on payment of a very high proportion of the disputed demand before granting stay of the balance demand. This often results in hardship for the taxpayers seeking stay of demand.*

4. *In order to streamline the process of grant of stay and standardize the quantum of lump sum payment required to be made by the assessee as a pre-condition for stay of demand disputed before CIT (A), the following modified guidelines are being issued in partial modification of Instruction No. 1914:*

   (A) In a case where the outstanding demand is disputed before CIT (A), the assessing officer shall grant stay of demand till disposal of first appeal on payment of 15% of the disputed demand, unless the case falls in the category discussed in pars (B) hereunder.

   (B) In a situation where,

      (a) the assessing officer is of the view that the nature of addition resulting in the disputed demand is such that payment of a lump sum amount higher than 15% is warranted (e.g. in a case where addition on the same issue has been confirmed by appellate authorities in earlier years or the decision of the Supreme Court /or jurisdictional High Court is in favour of Revenue or addition is based on credible evidence collected in a search or survey operation, etc.) or,

      (b) the assessing officer is of the view that the nature of addition resulting in the disputed demand is such that payment of a lump sum amount lower than 15% is warranted (e.g. in a case where addition on the same issue has been deleted by appellate authorities in earlier years or the decision of the Supreme Court or jurisdictional High Court is in favour of the assessee, etc.), the assessing officer shall refer the matter to the administrative Pr. CIT/ CIT, who after considering all relevant facts shall decide the quantum/ proportion of demand to be paid by the assessee as lump sum payment for granting a stay of the balance demand.

   (C) In a case where stay of demand is granted by the assessing officer on payment of 15% of the disputed demand and the assessee is still aggrieved, he may approach the jurisdictional administrative Pr. CIT/ CIT for a review of the decision of the assessing officer.

   (D) The assessing officer shall dispose of a stay petition within 2 weeks of filing of the petition. If a reference has been made to Pr. CIT/ CIT under para 4 (B) above or a review petition has been filed by the assessee under para 4 (C) above, the same shall also be disposed of by the Pr. CIT/ CIT within 2 weeks of the assessing officer making such reference or the assessee filing such review, as the case may be.

   (E) In granting stay, the Assessing Officer may impose such conditions as he may think fit. He may, inter alia,-

      (i) require an undertaking from the assessee that he will cooperate in the early disposal of appeal failing which the stay order will be cancelled;

(ii) reserve the right to review the order passed after expiry of reasonable period (say 6 months) or if the assessee has not cooperated in the early disposal of appeal, or where a subsequent pronouncement by a higher appellate authority or court alters the above situations;

(iii) reserve the right to adjust refunds arising, if any, against the demand, to the extent of the amount required for granting stay and subject to the provisions of section 245.

5. These instructions/ guidelines may be immediately brought to the notice of all officers working in your jurisdiction for proper compliance.

(A.K. Sinha)
Director (ITCC)

2.2 Analysing CBDT's Office memorandum dated 29.02.2016 regarding Stay of Demand

Reference to the relevant paragraph in the Union Budget Speech 2016	Paragraph 169 of the Union Budget 2016 *"The Income-tax Department is also issuing instruction making it mandatory for the assessing officer to grant stay of demand once the assesse pays 15% of the disputed demand, while the appeal is pending before Commissioner of Income-tax (Appeals). In case of deviation, assessing officer has to get orders of his superiors. The tax payer also has an option to go to superior officer in case he does not agree with conditions of stay order passed by the subordinate officer."*
Reference to the present office memorandum	F.No.404/72/93-ITCC dated 29.02.2016
Why this new office memorandum?	For partial modification of Instruction No. 1914 dated 02.12.1993 to provide for guidelines for stay of demand at the first appeal stage
What is the existing provision in Instruction No. 1914 dated 02.12.1993 on the subject?	Ref: part 'C'of the Instruction • A demand will be stayed only if there are valid reasons for doing so • Mere filing of an appeal against the assessment order will not be a sufficient reason to stay the demand. • While granting stay, the Assessing officers (AO) may require the assessee to offer a suitable security (bank guarantee, etc.) and/ or require the assessee to pay a reasonable amount in lump sum or in instalments.
What is the hardship faced by assessees at present	AOs often insist on payment of a very high proportion of the disputed demand before granting stay of the balance demand. This often results in hardship for the taxpayers seeking stay of demand.
What is sought to be achieved through this new office memorandum?	To streamline and standardize the quantification of the 'lumpsum amount' to be paid by the assessee in order to grant stay of the balance amount by the AO
What are the new conditions vis-à-vis grant of stay?	• the outstanding demand shall be disputed before CIT (A) • the AO shall grant stay of demand till disposal of first appeal on payment of 15% of the disputed demand • Subject to the two exceptions that are listed below
Exception 1 – AO can demand payment of a sum higher that 15%	If the AO is of the view that the nature of addition resulting in the disputed demand is such that payment of a lump sum amount higher than 15% is warranted (e.g. in a case where addition on the same issue has been confirmed by appellate authorities in earlier years or the decision of the Supreme Court / or jurisdictional High Court is in favour of Revenue or addition is based on credible evidence collected in a search or survey operation, etc.) or,

Exception 2 – AO can permit payment of a sum lower that 15%	If the AO is of the view that the nature of addition resulting in the disputed demand is such that payment of a lump sum amount lower than 15% is warranted (e.g. in a case where addition on the same issue has been deleted by appellate authorities in earlier years or the decision of the Supreme Court or jurisdictional High Court is in favour of the assessee, etc.)
What should the AO do in cases of Exception 1 or Exception 2?	The AO shall refer the matter to the administrative Pr. CIT/ CIT, who after considering all relevant facts shall decide the quantum/ proportion of demand to be paid by the assessee as lump sum payment for granting a stay of the balance demand.
The AO grants stay of demand after payment of 15% of disputed tax by assessee and if the assessee is still aggrieved, what shall he do?	The assessee can approach the jurisdictional administrative Pr. CIT/ CIT for a review of the decision of the assessing officer.
Time limit for disposing off the stay application by AO	The AO shall dispose of a stay petition within 2 weeks of filing of the petition
Time limit before Pr. CIT or CIT of disposing off AO's reference application or assessee's review application	The same shall be disposed of by the Pr. CIT/ CIT within 2 weeks of the assessing officer making such reference or the assessee filing such review, as the case may be.
Conditions that can be imposed by the AO for granting stay of demand	The AO may impose such conditions as he may think fit. He may, inter alia • require an undertaking from the assessee that he will cooperate in the early disposal of appeal failing which the stay order will be cancelled; • reserve the right to review the order passed after expiry of reasonable period (say 6 months) or if the assessee has not cooperated in the early disposal of appeal, or where a subsequent pronouncement by a higher appellate authority or court alters the above situations; • reserve the right to adjust refunds arising, if any, against the demand, to the extent of the amount required for granting stay and subject to the provisions of section 245.
Effective date	Immediate effect from 29.02.2016

2.3 Revised guidelines for Stay of Demand at first appellate stage

Government of India

Ministry of Finance

Department of Revenue

Central Board of Direct Taxes

PRESS RELEASE

New Delhi, 3rd March, 2016

Subject: Issue of revised guidelines for stay of demand at the first appeal stage – regarding

With a view to streamline the process of grant of stay of demand when the case of the taxpayer is pending before Commissioner (Appeals) and to standardize the quantum of lump sum payment required to be made by the assessee as a pre-condition for stay of demand disputed, the Central Board of Direct Taxes has issued fresh guidelines to the field authorities of the Income Tax Department.

2. Under the revised guidelines, where the outstanding demand is disputed before Commissioner (Appeals), the assessing officer shall grant stay of demand till disposal of first appeal on payment of 15% of the disputed demand. In case any deviation from the standard pre-payment of 15% is proposed by the assessing officer, he shall refer the matter to the administrative Principal Commissioner or Commissioner, who after considering all

relevant facts shall decide the quantum/ proportion of demand to be paid by the assessee as lump sum payment for granting a stay of the balance demand. In a case where stay of demand is granted by the assessing officer on payment of 15% of the disputed demand and the assessee is still aggrieved, he may approach the jurisdictional administrative Principal Commissioner or Commissioner for a review of the decision of the assessing officer.

3. *This decision of the Board is expected to provide significant relief to the taxpayers in matters relating to grant of stay and recovery of demand by reducing arbitrariness in the disposal of stay petitions where the tax demand is contested at the first appellate stage.*

2.4 CBDT's clarification on instructions on Stay of Demand Letter [F.No. 404/10/2009-ITCC], dated 1-12-2009

Many queries have been received regarding the applicability of Instruction number 95 dated 21.8.1969 vis-à-vis Instruction number 1914 dated 02.12.1993. Many assesses are taking the plea that Instruction No. 1914 does not supercede Instruction No. 95 dated 21.8.1969.

1. Instruction No. 95 dated 22.8.1969 was an assurance given by the then Deputy Prime Minister during the 8th Meeting of the Informal Consultative Committee held on 13th May, 1969.

   The observations made by the Deputy Prime Minister were as under:- "*Where the income determined on assessment was substantially higher than the returned income, say twice the latter amount or more, the collection of the tax in dispute should be held in abeyance till the decision on the appeal provided there were no lapses on the part of the assesses*."

   The above observations were circulated to the field officers by the Board as Instruction number 95 dated 21.8.1969.

2. The matter has been considered by the Board and the decision of the Board has been approved by the Finance Minister. It is hereby clarified that subsequent to Instruction No. 95 following Instructions/ clarifications on the stay of demand were issued till 15th October 1980:-

   (i) Clarification to Instruction number 95 was issued on 14/09/1970 stating that it relates to disputed demands only.

   (ii) Instruction number 635 was issued on 12/11/1973 stating that stay should be granted only in those cases where demands are attributable to substantial points of dispute.

   (iii) Clarification to Instruction number 95 dated 13/07/1976 held that the Instruction becomes operative only in cases where there are no lapses on the part of the assessee.

   (iv) Instruction number 1067 dated 21/06/1977 held that the ITO can pass the necessary orders u/s 220 (6) in all cases except cases under section 144A or 144B where the approval of IAC is required.

   (v) Instruction number 1158 dated 27th March 1978 held that in suitable cases the assessee may be allowed to furnish security.

   (vi) Instruction number 1282 dated 4th October 1979 held that requests should be made to Commissioner of Income-tax(Appeals) and ITAT for early disposal of appeals and constant watch should be kept on progress of appeals.

   (vii) Instruction number 1362 was issued on 15/10/1980 in supersession of all the earlier Instructions. It was an Instruction covering the issue in detail and in para 4 of the same there was a clear reference to the proposition laid down in Instruction number 95. In exercising this discretion, the Income-tax Officer should take into account factors such as:

   - whether the points in dispute relate to facts;
   - whether they arise from different interpretations of law;
   - whether the additions have been made as a result of detailed investigation;
   - whether the additions are based on materials gathered through enquiry/survey/search and seizure operations;
   - whether the disputed addition to income has been assessed elsewhere by way of protective assessment and the tax thereon has been paid by such person etc.

   The magnitude of addition to income returned cannot be the sole determinant in this regard. Each disputed addition will need to be considered to arrive at the quantum of tax that may need to be stayed.

3. It is clear that the substance of the assurance as laid down in Instruction number 95 dated 21.8.1969 was submerged in the Instruction number 1362 dated 15/10/1980 which was issued in supersession of all earlier Instructions on the subject.

   Instruction No. 1914 dated 02.12.1993 was issued subsequently in super-session of all the earlier Instructions on the subject and the said Instruction also covers unreasonably high pitched assessment order and genuine hardship cases.

4. It is therefore clarified that there is no separate existence of the Instruction number 95 dated 21.8.1969. Instruction number 95 and all subsequent Instructions on the issue ceased to exist from the date Instruction No. 1362 came into operation. In turn, Instruction number 1362 and all subsequent Instructions on the issue also ceased to exist the day Instruction number 1914 came into operation i.e. 02/12/1993.The Instruction number 1914 holds the field currently.

2.5 RECOVERY OF OUTSTANDING TAX DEMANDS [Instruction No. 1914 F. No. 404/72/93 ITCC dated 02-12-1993 from CBDT]

1. The Board has felt the need for a comprehensive instruction on the subject of recovery of tax demand in order to streamline recovery procedures. This instruction is accordingly being issued in supersession of all earlier instructions on the subject and reiterates the existing Circulars on the subject.

2. The Board is of the view that, as a matter of principle, every demand should be recovered as soon as it becomes due. Demand may be kept in abeyance for valid reasons only in accordance with the guidelines given below:

   A. Responsibility:

      i. It shall be the responsibility of the Assessing Officer and the TRO to collect every demand that has been raised, except the following:

         (a) Demand which has not fallen due;

         (b) Demand which has been stayed by a Court or ITAT or Settlement Commission;

         (c) Demand for which a proper proposal for write-off has been submitted;

         (d) Demand stayed in accordance with paras B & C below.

      ii. Where demand in respect of which a recovery certificate has been issued or a statement has been drawn, the primary responsibility for the collection of tax shall rest with the TRO.

      iii. It would be the responsibility of the supervisory authorities to ensure that the Assessing Officers and the TROs take all such measures as are necessary to collect the demand. It must be understood that mere issue of a show cause notice with no follow-up is not to be regarded as adequate effort to recover taxes.

   B. Stay Petitions:

      Stay petitions filed with the Assessing Officers must be disposed of within two weeks of the filing of petition by the tax- payer. The assessee must be intimated of the decision without delay.

      Where stay petitions are made to the authorities higher than the Assessing Officer (DC/CIT/ CC), it is the responsibility of the higher authorities to dispose of the petitions without any delay, and in any event within two weeks of the receipt of the petition. Such a decision should be communicated to the assessee and the Assessing Officer immediately.

      The decision in the matter of stay of demand should normally be taken by Assessing Officer/ TRO and his immediate superior. A higher superior authority should interfere with the decision of the Assessing Officer/Tax Recovery Officer only in exceptional circumstances; e.g., where the assessment order appears to be unreasonably high-pitched or where genuine hardship is likely to be caused to the assessee. The higher authorities should discourage the assessee from filing review petitions before them as a matter of routine or in a frivolous manner to gain time for withholding payment of taxes.

C. Guidelines for staying demand:

A demand will be stayed only if there are valid reasons for doing so. Mere filing an appeal against the assessment order will not be a sufficient reason to stay the recovery of demand. A few illustrative situations where stay could be granted are: It is clarified that in these situations also, stay may be granted only in respect of the amount attributable to such disputed points. Further where it is subsequently found that the assessee has not co-operated in the early disposal of appeal or where a subsequent pronouncement by a higher appellate authority or court alters the above situation, the stay order may be reviewed and modified. The above illustrations are, of course, not exhaustive. ii. In granting stay, the Assessing Officer may impose such conditions as he may think fit. Thus he may — a. require the assessee to offer suitable security to safeguard the interest of revenues, b. require the assessee to pay towards the disputed taxes a reasonable amount in lump sum or in instalments, c. require an undertaking from the assessee that he will co-operate in the early disposal of appeal failing which the stay order will be cancelled. d. reserve the right to review the order passed after expiry of a reasonable period, say up to 6 months, or if the assessee has not co-operated in the early disposal of appeal, or where a subsequent pronouncement by a higher appellate authority or court alters the above situations; e. reserve a right to adjust refunds arising, if any, against the demand. iii. Payment by instalments may be liberally allowed so as to collect the entire demand within a reasonable period not exceeding 18 months. iv. Since the phrase "*stay of demand*" does not occur in section 220(6) of the Income-tax Act, the Assessing Officer should always use in any order passed under section 220(6) [or under section 220(3) or section 220(7)], the expression that occurs in the section viz., that he agrees to treat the assessee as not being default in respect of the amount specified, subject to such conditions as he deems fit to impose. v. While considering an application under section 220(6), the Assessing Officer should consider all relevant factors having a bearing on the demand raised and communicate his decision in the form of a speaking order.

D. Miscellaneous:

i. Even where recovery of demand has been stayed, the Assessing Officer will continue to review the situation to ensure that the conditions imposed are fulfilled by the assessee failing which the stay order would need to be withdrawn.

ii. Where the assessee seeks stay of demand from the Tribunal, it should be strongly opposed. If the assessee presses his application, the CIT should direct the departmental representative to request that the appeal be posted within a month so that Tribunal's order on the appeal can be known within two months.

iii. Appeal effects will have to be given within 2 weeks from the receipt of the appellate order. Similarly, rectification application should be decided within 2 weeks of the receipt thereof. Instances where there is undue delay in giving effect to appellate orders, or in deciding rectification applications, should be dealt with very strictly by the CCITs/CITs.

3. The Board desires that appropriate action is taken in the matter of recovery in accordance with the above procedure. The Assessing Officer or the TRO, as the case may be, and his immediate superior officer shall be held responsible for ensuring compliance with these instructions.

4. This procedure would apply mutatis mutandis to demands created under other Direct Taxes enactments also.

3.0 Stay Application

3.1 Suggested contents of a Stay application

The following points must be kept in mind by assessees and incorporated in stay applications according to the facts and circumstances of the case:

(i) Assessment history of assessee;

(ii) Good conduct and cooperation of the assessee with the Department in the past including promptness in discharging tax liability;

(iii) Appeal filed with CIT (A) and points raised in the appeal – It would be a good practice to enclose a copy of the appeal memo filed before the CIT (A);

(iv) Description of financial difficulties, if any, and how genuine hardship and irreparable loss would be caused to the assessee if tax was to be recovered immediately;

(v) Case on merits of the assessee including reliance on judicial precedents, if any – It is important to note that even if there are no financial difficulties, stay can be granted if a strong prima facie case in merits is made out as held in the case of ***Benara Valves Ltd. v. CCE [2006] 13 SCC 347 (SC)/ Slum Rehabilitation Authority v. DDIT (E) [2015] 275 CTR 40 (Bom.).***

(vi) If the demand relates to issues that have been decided in assessee's favour by an appellate authority or court earlier, the same should be pointed out. This is because stay ought to be granted in such cases as per Instruction No. 1914. Even if the earlier decision of the appellate authority or court is not in case of that assessee itself, stay can be granted if demand in dispute related to issues that had been decided in another assessee's favour on same facts as held in the case of ***Kalapet Primary Agricultural Co-op. Credit Society Limited v. ITO & Ors. [2015] 378 ITR 658 (Mad.).*** Therefore, if the assessee's relies on a judgement in some other case, it must endeavour to demonstrate how the facts of that case were identical or similar to assessee's facts;

(vii) The fact of income being determined at a substantially higher than the returned income should be expressly brought out, and reliance must be placed on Instruction No. 96 –**[*Valvoline Cummins Limited v. DCIT & Ors. [2008] 307 ITR 103 (Del.) (HC)*];**

(viii) The relevant portion of the Instructions or judgements according to which a stay is deserved must be quoted in the stay application itself and a copy of the Instruction/ judgements must be enclosed;

(ix) The assessee must check calculation of tax, interest and other liability raised by the Assessing Officer, and any mistake in the same must be brought out in the stay application along with the amount of demand affected by such mistakes;

(x) If there are any mistakes apparent from the record in the assessment order, the assessee must file a rectification application under section 154 of the Act to point them out. Also, a prayer must be made in the stay application to the effect that no coercive recovery measures may be taken till the disposal of the rectification application – *Sultan Leather Finishers (P.) Ltd. v. ACIT & Ors. [1991] 191 ITR 179 (All.)*;

(xi) A prayer requesting an opportunity of being heard must be made in the end.

3.2 Stay application before Commissioner of Income-tax (Appeals)

Commissioner of Income Tax (Appeals) has powers to stay demand. Power to stay is inherent in right to appeal itself as in some cases refusal to stay may result into denial of effective appeal itself –***ITO v. M. K. Mohd. Kunhi (1969) 71 ITR 815 (SC)***. Where the assessee fails to exercise his discretion, the assessee may move the Commissioner of Income-tax (Appeals). Commissioner of Income-tax (Appeals) has powers even independent of sec. 220(6)- **[*CIT v. Duncan Stration & Co . Ltd. (1983) 140 ITR 1025 (Bom.*)]** Even without making an application u/s. 220(6), the assessee may move Commissioner of Income-tax (Appeals) for stay- ***Kesav Cashew Co. v. DCIT & Ors. (1994) 210 ITR 1014 (Ker.*) .**

Though the statute has not conferred specific power to grant stay to the Commissioner of Income Tax (Appeals), courts have held that in view of the propositions laid down by the Supreme Court in ***ITO v. M.K. Mohammed Kunhi (1969) 71 ITR 815 (SC)***, the first appellate authority has power to grant stay, which is incidental and ancilliary to its appellate jurisdiction.

Some of the important judicial pronouncements in this regard are as follows-

For invoking the power of Commissioner of Income-tax(Appeals) to grant stay of demand, it is not necessary that the assessee should first approach the Assessing Officer under section 220(6) or that the Assessing Officer should reject the assessee's prayer for stay.

Tin Mfg. Co. of India v. CIT & Ors.(1995) 212 ITR 451 (All.)

Bongaigon Refinery & Petrochemicals Ltd. v. CIT (1999) 239 ITR 871 (Gauhati)

The recovery proceedings initiated against the assessee shall remain stayed till the disposal of stay petition filed by him. ***Pradeep Ratanshi v. Asst. CIT & Ors. (1996) 221 ITR 502 (Ker.)***

Stay **ought to be granted in deserving cases**. (*Paulsons Litho Works v. ITO (1994) 208 ITR 676(Mad.)).* It is now a settled principle that during the pendency of an appeal before the Commissioner of Income-tax(Appeals), an application for stay can be filed before the Commissioner of Income-tax(Appeals) – **{Refer *GERA Realty Estates v. CIT (A) & Ors. [2015] 368 ITR 366 (Bom.)/ Maheshwari Agro Industries v.UoI [2012] 346 ITR 375 (Raj.)}.** Therefore, instead of filing a stay application before the Assessing Officer, an assessee can also

directly file a stay application before the Commissioner of Income-tax(Appeals) during the pendency of the appeal with the latter. The contents of the stay application whether filed before the Assessing Officer or before the Commissioner of Income-tax(Appeals) should remain the same.

It is important to note the decision in the case of ***UTI Mutual Fund v. ITO [2012] 345 ITR 71 (Bom.)***, coercive measures for recovery should not be taken pending application for stay and for a reasonable period thereafter to enable assessee to move a higher forum. In case a stay application is filed before the Commissioner of Income-tax(Appeals) and is pending before him, it is advisable for assessees to write a letter to the Assessing Officer requesting that no coercive measures for recovery may be taken in light of this judgement.

The opportunity to file a stay application must be used by assessees to bring on record all facts and material demonstrating how stay is deserved in the case. Also, since Assessing Officers are mandated to pass speaking orders on stay applications, it is imperative that assessees file comprehensive stay applications and cursory applications for stay of demand must be avoided.

Where assessee has moved an application for rectification and the same was pending, recovery proceedings cannot be taken.

The Authority empowered to stay the recovery proceedings is the '*Assessing Officer*' who is empowered u/s. 220(6) of the Act.

Where an assessee has presented an appeal under section 246 or section 246A the Assessing Officer may, in his discretion and subject to such conditions as he may think fit to impose in the circumstances of the case, treat the assessee as not being in default in respect of the amount in dispute in the appeal, even though the time for payment has expired, as long as such appeal remain undisposed of.

The powers of the Assessing Officer to stay the demand are valid only up to the order of the First Appellate Authority. Administrative Commissioner is also competent to grant stay- ***K.C. Joy v. TRO & Ors. (1993) 204 ITR 511 (Ker.)***

After the order of the Commissioner of Income-tax(Appeals), the assessee can either accept the same or move an appeal before the Tribunal in which case, an application would have to be moved to the Tribunal. [*Emcete & Sons P. Ltd. v. ITO (1968) 70 ITR 265 (Mad.); CIT v. Mohanlal Gokuldas & Co. (1974) 095 ITR 537 (AP*)]. Commissioner has powers to stay demand- *RPG Enterp. Ltd. v. DCIT (2001) 251 ITR (AT) 20 (Bom*.).

3.3 Principles to be followed in case of deciding Stay applications

The Assessing Officer's responsibility is judicial in nature, it is not a naked arbitrary power but a power coupled with responsibility- ***KEC International Ltd. v. B. R. Balakrishnan & Ors. (2001) 251 ITR 158 (Bom.)***. Principles lay down by Bom. H.C. in *KEC Int'l* (supra)-

(a) While considering the stay application, the authority concerned will at least briefly set out the case of the assessee.

(b) In cases where the assessed income under the impugned order far exceeds returned income, the authority will consider whether the assessee has made out a case for unconditional stay. If not, whether looking to the questions involved in appeal, a part of the amount should be ordered to be deposited for which purpose, some short prima facie reasons could be given by the authority in its order.

(c) In cases where the assessee relies upon financial difficulties, the authority concerned can briefly indicate whether the assessee is financially sound and viable to deposit the amount if the authority wants the assessee to so deposit.

(d) The authority concerned will also examine whether the time to prefer an appeal has expired. Generally, coercive measures may not be adopted during the period provided by the statute to go in appeal. However, if the authority concerned comes to the conclusion that the assessee is likely to defeat the demand, it may take recourse to coercive action for which brief reasons may be indicated in the order.

(e) We clarify that if the authority concerned complies with the above parameters while passing orders on the stay application, then the authorities on the administrative side of the Department like respondent No. 2 herein need not once again give reasoned order. The above parameters are not exhaustive. They are only recommendatory in nature.

The Finance (No.2) Act, 1998 with effect from 1-10-1998 inserted sub-section (7) in section 253 prescribing for the first time a fee of five hundred rupees whenever an application for stay of demand has to be filed before the Appellate Tribunal.

The Finance Act, 2001 inserted two new proviso to sub-section (2A) of section 254 with effect from 1-6-2001. As per the first proviso, where an order of stay is made in any proceedings relating to an appeal filed under section 253(1), the Tribunal shall dispose of the appeal within a period of one hundred and eighty days from the date of such stay order.

As per the second proviso if such appeal is not so disposed of within the period specified in first proviso, the stay order shall stand vacated after the expiry of the said period.

In view of the specific language of the aforesaid second proviso, it is not only desirable but imperative on the part of the assessee to file an application for extension of the stay or granting of fresh stay, well in time before the expiry of the impugned six months period.

3.4 Rule 35A of the Income Tax Appellate Tribunal Rules

Rule 35A of the Income-tax Appellate Tribunal Rules prescribes the procedure for filing the Stay Petition. As per this rule, any assessee filing an appeal under taxation Laws, before the Income Tax Appellate Tribunal may prefer stay application in the following manner.

1. (a) Every application for stay of recovery of demand of tax, interest, penalty, fine, Estate Duty or any other sum shall be presented in Triplicate by the applicant in person, or by his duly authorised agent, or sent by Registered Post to the Registrar/Deputy Registrar or the Assistant Registrar, as the case may be at the Headquarters of a Bench or Benches having jurisdiction to hear the appeals in respect of which the Stay Application arises.

   (b) Where the application for stay relates to demands, though for more than one assessment year but under only a single statutory enactment, then a single stay application would be sufficient in respect of the demands for which the stay is sought. However, separate applications shall be filed for stay of recovery of demands under different enactments. It may however be noted that in Wipro Ltd vs. ITO, 86 ITD 407 (Bang) the Tribunal held that separate stay petitions should be filed seeking stay and recovery of different assessment years. But the Bombay bench of the Tribunal in *Chiranjilal S. Goenka v. WTO, (2000) 66 TTJ 728* has held that a single application can be filed.

   (c) The application for stay should, as far as possible, be filed in the form.

2. Every application shall be neatly typed on one side of the paper and shall be in English and shall set forth concisely the following:

   Summary of facts regarding the demand of the tax, interest, penalty, fine, Estate Duty or any other sum, the recovery of which is sought to be stayed;

   The result of the appeal filed before the Commissioner (Appeals) or the Deputy Commissioner (Appeals), if any;

   The exact amount of the tax, interest, penalty, fine, Estate Duty or any other sum demanded, as the case may be, and the amount undisputed there from and the amount outstanding;

   The date of filing of the appeal before the Tribunal and its number, if known;

   Whether any application for stay was made to the revenue authorities concerned and if so, the result thereof (copies of correspondence, if any, with the Revenue authorities to be attached);

   Reasons in brief for seeking the stay;

   Whether the applicant is prepared to offer any security in respect of the demand of tax in dispute and if so, in what form;

   Prayer to be mentioned clearly and concisely (stating exact amount sought to be stayed);

   The contents of the application shall be supported by an affidavit sworn by the applicant or his duly. Remedy where discretion is not exercised judiciously.

3.5 Judicial Decisions

M. G. M. Transports (Madras) P. Ltd. v. ITO & Anr. [2008] 303 ITR 115 (Mad)

"*The then the Deputy Prime Minister had observed as under :*

> *'. . . where the income determined on assessment was substan tially higher than the returned income, say, twice the latter amount or more, the collection of the tax in dispute should be held in abeyance till the decision on the appeals, provided there were no lapse on the part of the assessee.'*

The Board desires that the above observations may be brought to the notice of all the Income-tax Officers working under you and the powers of stay of recovery in such cases up to the stage of first appeal may be exercised by the Inspecting Assistance Commissioner/ Commissioner of Income-tax." (Instruction No. 96 F. No. 1/6/69- ITCC, dated August 21, 1969) and also the judgments of N. Rajan Nair v. ITO & Anr. [1987] 165 ITR 650 (Ker) and Mrs. R. Mani Goyal v. CIT & Anr. [1996] 217 ITR 641 (All).

It is not as if the correctness of the assessment order is put in issue before this court. During the pendency of the appeal or even prior to that, after passing the assessment order, the petitioner as per law prayed for stay of recovery. The Central Board of Direct Taxes has issued instructions as above referred to. In this case, it is not in dispute that a high pitch assessment has been made assessing a sum of Rs. 5,01,132,504. Hence, I am of the view that the instructions would squarely apply to the case of the petitioner. The mere statement in the impugned order without any factual foundation that the "no valid reason has been stated for stay of the demand" by the Assessing Officer cannot be appreciated. When the petitioner has relied on the Department's own guidelines, the Assessing Officer would have rejected the circular by giving reasons for coming to the conclusion that the circular would not be applicable to the petitioner or accept the same and grant the relief as prayed for by the petitioner. Without doing so, by simply saying that the assessee had no valid reason for the grant of stay order cannot be legally sustainable. It is submitted across the Bar that after passing of the assessment order, the Assessing Officer has forcibly withdrawn a sum of Rs. 7.5 lakhs from the bank account of the petitioner. The said payment is recorded.

Having regard to the above said facts and circumstances of the case, with particular reference to the instructions issued by the Central Board of Direct Taxes, which is extracted above, I am of the view that the petitioner is entitled to stay of the collection till orders are passed in the appeal, subject to making certain payment.

Accordingly, the writ petition is disposed of and there will be an order of stay of collection of demand of tax for the assessment year 2004-05 till orders are passed in the appeal, subject to the petitioner making payment."

In the case of New Rupayan Jewellers v. Union of India & Ors (2009) 314 ITR 0288 :(2009) (Cal. HC)*, it was held that "*From a perusal of the order impugned I find that discretion has been exercised mechanically and without the application of mind. Since an assessee has a statutory right to prefer appeal against an order of assessment, the observation of the assessing officer in the order impugned that "your petition for granting stay in the realisation of demand for the assessment year 2006-07 is not acceptable merely on the ground that you have filed an appeal against the said assessment order" is against the spirit of the statute. That apart the observation "the respective additions were made with perfect marshalling of facts" is uncalled for as it is the subject-matter of the appeal preferred against the order of assessment. Since discretion has to be exercised in a sound and judicious manner, which in the instant case was not done, the order dated November 10, 2008, under challenge cannot be sustained and is, thus, set aside and quashed. Since appeal has been preferred and is pending, respondent No. 2 is directed to dispose of the appeal preferably within a period of eight weeks from the date of communication of this order."

The Authority is expected to pass a speaking order while deciding an application. [*Dunlop (I) Ltd. (No. 2) v. ACIT & Ors. (1990) 183 ITR 532 (Cal.); Mohd. Abdul Sattar Sait v. CBDT & Ors. (1979) 120 ITR 653 (Ker.), Bharat Nidhi Ltd. v. UoI & Anr. (1973) 92 ITR 1 (Del*.); *RPG Enterp. Ltd. v. DCIT (2001) 251 ITR (AT) 20 (Bom*.)].

Rejection should be by a speaking order- *T**eletube Electronics Ltd. v. CIT (1998) 230 ITR 705 (Del*.).

Tribunal has powers to stay the demand- *Mohd. Kunhi* - The S.C. observed as under: "*the power of stay by the Tribunal is not likely to be exercised in a routine way or as a matter of course in view of the special nature of taxation and revenue laws. It will only be when a strong prima facie case is made out that the Tribunal will consider whether to stay the recovery proceedings and on what conditions, and the stay will be granted in most deserving and appropriate cases where the Tribunal is satisfied that the entire purpose of the appeal will be frustrated or rendered nugatory by allowing the recovery proceedings to continue during the pendency of the appeal*."

Tribunal cannot refuse stay just because CIT has granted conditional stay- ***Ashok Kumar Aggarwal v. ITAT & Ors. (1997) 226 ITR 490 (Del.)***The demand should be stayed during the gap i.e. period during which stay application is made & until it is disposed off- ***Bongaigaon Refinery & Petro Chemicals Ltd. v. CIT & Ors. (2002) 256 ITR 698 (Gau.)***. Recovery proceedings without disposing of stay application, is bad- ***M.G.M Transport (Madras) Ltd. v. ITO & Anr. (2008) 303 ITR 115(Mad.);Dr. T.K. Shanmugasundaram v. CIT & Ors. (2008) 303 ITR 387 (Mad.).***

The Hon'ble A. P. High Court in ***ITO vs. Khalid Mehdi Khan (minor) (1977) 110 ITR 79***, has taken the view that the Tribunal can not only stay the recovery proceedings but can also stay the proceedings before the Assessing Officer. Therefore, in a case where order under section 263 is passed and if the appeal is pending before Tribunal and in the meantime, if the Assessing Officer starts the assessment proceedings then in such circumstances, the assessee can file stay petition before the Tribunal and the Tribunal can stay the proceedings before the Assessing Officer.

The Hon'ble Supreme Court in ***CIT vs. Bansi Dhar & Sons and CIT v. Chathuram Bhadani, etc. (1986) 157 ITR 665*** has taken the view that the Tribunal can also stay the proceedings when the reference is pending before the High Court. Therefore, in cases where the assessee has lost before the Tribunal and the reference is pending before the High Court and if the assessee is in a position to establish that he is not in a position to make the payment of tax in dispute, in such circumstances, the Tribunal can stay the proceedings till the disposal of the reference by the High Court.

It may be noted here that, before filing the stay petition, it is necessary that the assessee should approach the Commissioner to stay the recovery proceedings. When Commissioner refuses to stay the recovery proceedings, then only the Tribunal will exercise its power. In case the Commissioner grants instalment facility but the assessee shows his inability to make payment in instalment and the Commissioner rejects the stay application then the power of Tribunal can be invoked for stay. It may be further noted that the assessee must also show that he has no liquidity to pay the tax in dispute and if stay is not granted, great hardship will be caused to the assessee.

Where the Assessing Officer refuses to exercise his discretion or exercises it in a capricious or arbitrary manner or by taking into consideration irrelevant or extraneous considerations, the option before an assessee is to file a writ petition under Article 226 before the jurisdictional High Court.

In ***Dunlop India Ltd. (No. 2) v. ACIT & Ors. (1990) 183 ITR 532***, the Division Bench of the Calcutta High Court found that while using discretion for the purposes of section 220(6), the office concerned had not appropriately dealt with or taken into consideration all the relevant factors which were necessary to be dealt with and considered. The Court, therefore, sent back the matter to the officer concerned for reconsideration and for giving due and proper reasons.

However, in ***India Foils Ltd. v. IAC of IT & Ors. (1990) 186 ITR 429 (Cal.)*** the Calcutta High Court dismissed the writ petition because application for stay of tax was rejected by the Assessing Officer by giving proper reasons and there was no perversity in the order. It may, however be noted that High Court, as a rule, in proceedings under Article 226, does not grant any stay of recovery of tax except under very exceptional circumstances.

4.0 Conclusion

As a taxpayer-friendly measure, the Finance Minister while introducing Finance Bill, 2016 mentioned that the tax department is also issuing instructions making it mandatory for the Assessing Officer to grant a Stay of Demand once the tax payer pays 15% of the disputed demand, while the appeal is pending before the Commissioner of Income-tax (Appeals). In line with this statement, the CBDT has issued these guidelines, which can provide relief to taxpayers while applying for a Stay of Demand at the first appellate stage. The guidelines also provide specific timelines to dispose of the application for the Stay of Demand and the related review petition.

NOTES

NOTES

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