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TAX TRIBUNAL UPHOLDS THE CHARACTERISATION OF SHARE CAPITAL INFUSION AS 'NOT CLEAN MONEY'; LAYS DOWN IMPORTANT GUIDELINES FOR ENQUIRY

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Introduction

In the recent ruling (dated 31 December 2019) of *ITO v APJ Construction Private Limited* (ITA No. 722/Del/2015) (Ruling), the Income Tax Appellate Tribunal (Tribunal), has held that the tax officer's (Assessing Officer) characterisation of primary share capital infusion as 'not clean money' was accurate as the taxpayer company (issuer) had not clarified the doubts as to the genuineness of the 'identity' and 'creditworthiness' of the share applicants or 'genuineness of the transaction'. In doing so, the Tribunal also laid down a 15-point questionnaire which should be checked by the tax authorities to assess whether 'identity' and 'creditworthiness' of the share applicants and the 'genuineness of the transaction' are established or not.

Background

Section 68 of the Income-tax Act, 1961 (IT Act) provides for taxation of any sum (i.e. in the nature of share capital, unsecured loan etc.) credited in the books of account of a taxpayer if the taxpayer is unable to provide any satisfactory explanation about its nature and source (Section 68 Addition). In light of the judgments pertaining to this issue, the legal position is well-settled that a Section 68 Addition cannot be made if the taxpayer has discharged its *prima facie* onus of providing details, regarding the 'identity' of the payer / share applicant, 'creditworthiness' of the payer / share applicant and 'genuineness of the transaction' (ICG Test), to the tax authorities.

Tribunal Ruling

In this case, during FY 2004-05, APJ Construction Private Limited (Taxpayer) had received share capital infusion from certain shareholders (Share Capital Infusion). The assessment of the Taxpayer was reopened on the basis of a report of the Investigation Wing of the income-tax department to the effect that the Taxpayer was indulged in taking 'accommodation entries' in the form of Share Capital Infusion. In response to Assessing Officer's enquiries about the nature and source of the Share Capital Infusion, the Taxpayer submitted detailed documentary evidence including *inter alia* copies of share application forms, copies of income tax returns of the share applicants, their bank statements reflecting the payments for purchase of shares, copies of resolution for purchase of shares and copies of their financial statements along with audit reports to discharge its *prima facie* onus in relation to the ICG Test. Despite submission of all such details, the Assessing Officer made the Section 68 Addition in the hands of the Taxpayer for the Share Capital Infusion. Upon appeal to the first appellate authority (i.e. Commissioner of Income-tax (Appeals) or CIT(A)), the CIT(A) ruled in favour of the

Taxpayer and deleted the addition made by the Assessing Officer by observing that the Taxpayer had discharged its *prima facie* onus in relation to the ICG test. Consequently, the income-tax department preferred an appeal before the Tribunal.

The Tribunal remarked that merely because the Taxpayer was successful in completing the paperwork very meticulously, the tax authorities were not absolved of their statutory obligation (to verify the genuineness of such documents also in the light of the surrounding circumstances). Resultantly, the Tribunal ruled that the documents furnished by the Taxpayer in relation to the ICG Test could not have clarified the doubts in the mind of the Assessing Officer as to the genuineness of the Share Capital Infusion, thereby allowing the income-tax department's appeal. The Tribunal laid down certain guidelines (in the form of a 15-point questionnaire) which the tax authorities should keep in mind while assessing whether the 'identity' and 'creditworthiness' of the share applicants and the 'genuineness of the transaction' is established or not.

- Whether the two parties were related or known to each other, or mode by which parties approached each other?
- Whether the transaction was entered into through written documentation to protect investment?
- Whether the investor was an angel investor?
- What was the quantum of money invested?
- How the party believed the credit-worthiness of the recipient?
- What was the object and purpose of payment/investment?
- Whether the share applicant was in existence and an independent entity?
- How the financial capacity of the share applicant to invest funds was proved?
- How the source of funds from which the high share premium was invested was dealt with by the taxpayer?
- Why the investor companies had applied for shares of the taxpayer at a high premium?
- In case the field enquiry conducted by the assessing officer revealed that the investor companies were found to be non-existent, whether the onus to establish the identity of the investor companies was not discharged by the taxpayer?
- Whether the taxpayer discharged their legal obligation to prove the receipt of share capital/premium to the satisfaction of the assessing officer?
- Whether the taxpayer discharged the onus to establish the credit worthiness of the investor companies?
- Did the taxpayer do anything more than mere mention of the income tax file number of an investor to discharge the onus under section 68?
- Did the taxpayer do anything more than mere filing all the primary evidence in discharge of its onus to prove the identity of the investee?

Comments

In the case of PCIT v NRA Iron & Steel (P.) Ltd. (2019) 412 ITR 161 (SC), the Supreme Court of India had ruled *inter alia* that if the ground level enquiries and investigations reveal that the 'identity' of the creditors was dubious or doubtful, or lacked 'creditworthiness', then the 'genuineness of the transaction' would not be established. Further, in the Delhi High Court judgement of CIT v N.R. Portfolio (P.) Ltd. (2014) 264 CTR 258 (Delhi), it was held that 'creditworthiness' and genuineness of share capital infusion also depends on the nature of relationship between parties; object, terms and quantum of investment; types of investors; creditworthiness of the recipient, etc.

Lately, the instances of scrutiny (of primary infusions into companies) by income-tax authorities have been on the rise. Further, despite the settled position of law in relation to the ICG Test, Section 68 Additions are still being made by income-tax authorities – especially in cases where shares are issued at high premium. Taxpayers should ensure that at the time of entering such share capital infusion transactions, they have sufficient documentary evidence and explanations available to address the 15-point questionnaire outlined by the Tribunal in order to avoid any adverse consequences.

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