

## Section 68 Additions - Whose Onus was it Anyway?

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**Ashish Mehta**

Partner, Khaitan & Co.



**Sakshi Mehta**

Associate, Khaitan & Co.

It is often said that the moment one argues on onus of proof and on whom the burden of proving something lies, it is more likely that the side making such arguments will be on the losing side. Thus, as a strategy, especially in direct tax litigation, the onus of proof would generally be one's last resort. That, however, does not take anything away from how courts have dealt with and looked at the concept of burden of proof especially in the context of gauging the genuineness of transactions while considering the applicability of Section 68 of the Income Tax Act, 1961.

### ***Onus of Proof - Developments under law - A swinging pendulum?***

The burden of proof in the context of invoking Section 68 has been heavily litigated and this space has also seen legislative amendments. The settled law, at one point in time, was that where a credit is received from the assessee or a relative or an employee, etc. the burden to prove genuineness of the transaction would rest heavily on the assessee. Where the credit is not from such a party but a third party, the burden would still lie on the assessee to prove the identity of such third party and that such an entry is real and not *prima facie* fictitious. The onus would not be on the assessee to explain further how or in what circumstances the third party had obtained such funds and how or why such third party had approached the assessee to make a deposit of the same.

A proviso was inserted in Section 68 effective from 1 April 2013 (Assessment Year 2013-14) mandating explanation of nature and source of the amount credited in its books of accounts. Thus, post introduction of this proviso, merely providing names, addresses and PAN details of investors would not suffice; investee companies would be expected to provide in-depth details and lot more evidence.

### ***Noteworthy rulings***

One of the leading and often cited cases (pre-insertion of proviso to Section 68) was the Supreme Court ruling in the case of *Lovely Exports* [\[TS-85-SC-2008-O\]](#) wherein it was held that the onus of the assessee was discharged once name, address, PAN details of investor had been provided. It was further held that if tax department wishes to further investigate bogus shareholders, it would be free to initiate proceedings in their cases.

In case of private placement of shares in closely held companies, courts have held that merely submitting PAN details and identity of investors would not suffice and capacity of the investor as well as genuineness of the transaction would also need to be looked into and the onus to prove genuineness on all counts would lie heavily on the recipient assessee.

Then came the ruling in the case of *NRA Iron and Steel* [\[TS-106-SC-2019\]](#) wherein the Supreme Court held that in cases of private placement of shares, the company had an onus to prove to the authorities of the genuineness of the money received and was under a legal obligation to show that un-accounted money was not being converted through a cloak of share capital. This was a case where the assessee had been successful up to the Delhi High Court. However, the Supreme Court decided the case *ex parte* against the assessee on various counts (a review petition in this case was also dismissed). Some of the factors that influenced the Supreme Court in casting doubts on the genuineness of the transactions were negligible taxable incomes offered by the investors not commensurate with their investments, absence of justification for high share premiums, and non-availability of some investors at their mentioned addresses.

The Income Tax Appellate Tribunal, Mumbai Bench (Tribunal), in its recent ruling in case of *Leena Power Tech Engineers Pvt Limited (Taxpayer)* [\[TS-883-ITAT-2021\(Mum\)\]](#) has ruled that investments received by the Taxpayer for share subscription from 'shell' companies and through multiple- layered funding will not be considered a genuine transaction.

## **Background**

As narrated in the Tribunal order, this case involved transfer of funds to a company via banking channels carried out through a series of transactions by shell companies whereby share application money was raised from unrelated companies at huge premiums.

The Taxpayer, a private limited investment company, had received funds in the form of share application money from certain entities say 'R' and 'M'. The assessment was reopened in case of Taxpayer and additions were made by the tax officer on basis of information from investigation wing which indicated that such funds had been subjected to routing through several layered bank accounts wherein the Taxpayer had been named as the ultimate beneficiary. On being questioned, the Taxpayer failed to prove genuineness of the transaction to the satisfaction of the tax officer and additions were made to the Taxpayer's taxable income under Section 68. The Taxpayer approached the Commissioner of Income Tax (Appeals) and was granted relief.

Aggrieved, the Tax Department filed an appeal before the Tribunal which noted the arguments of both sides and made some key observations.

## **Arguments**

### **1. Bonafide transactions**

The tax officer contended that the Taxpayer was a beneficiary of a sophisticated money laundering scheme carried out through layered banking channels via the share subscription route. However, the Taxpayer had argued that the companies which had subscribed did not receive any cash deposits and even if there were layers the flow of funds, the same had not been shown by the tax officer.

### **2. Responsibility to show genuine transaction**

It was argued by the tax officer that the Taxpayer had a greater responsibility of showing genuineness of transaction and merely submission of PAN number, financial statements and returns of investor companies did not satisfy the conditions under the law. The information on these accounts and companies showed that there was no genuine business being undertaken. The Taxpayer contended that it had submitted the relevant documents prescribed by the tax officer and had no other onus and its obligations stood discharged.

### **3. Veracity of investigation**

The Taxpayer argued that the tax officer merely relied on the observations of investigation report and did not carry out any independent investigations. However, the tax officer defended the position by stating that it became difficult to prove the case to the hilt within a limited time period and the information provided by the Taxpayer showed that nature of transaction was clearly dubious.

### **Ruling**

The Tribunal took note of all the arguments as noted above and held that the burden was on the Taxpayer to prove 'genuineness' of the transaction i.e., bona fide nature and source of credits in its books of account, to the satisfaction of the tax officer.

The Tribunal observed that while a shell company in itself would not be an illegal entity, the act of abatement of, and being part of, financial manoeuvring to legitimise illicit monies and evade taxes, would take its actions beyond what was legally permissible. The only thing which would set a shell company apart from a genuine business entity would be lack of genuineness in its actual operations.

On examining the financial statements of 'R' and 'M', the Tribunal observed that no real activity had been carried out by these entities and almost all of the funds received by them had been passed onto other companies. There was also no mention of any revenues nor any telephone, office, equipment or other expenses in the balance sheet, which seemed difficult to believe especially given the aggressive manner in which these entities had undertaken investments at huge premiums. Further, all the funds that had been received by 'R' and 'M' had been transferred to the Taxpayer within a matter of days by repeating the same subscription model. Therefore, the Tribunal held that 'R' and 'M' were merely conduit companies without any independent business activities.

On perusal of the bank statements of 'R' and 'M', the Tribunal observed that certain payments had been made to the Taxpayer, but immediately preceding these transactions, certain repayment credit entries had been recorded. This seemed to have been a recurring cycle which did not inspire any confidence in the genuineness of the transaction.

Additionally, no information had been provided by the Taxpayer explaining who was controlling and managing 'R' and 'M' and its other associated entities. The entities involved in the transactions only provided different layers to the transaction and *de facto* hid the true investor. The shares were issued at a premium that too in a company which had no other activity except for routing the funds to another company (Taxpayer) by making investments therein at a huge premium. The Taxpayer was stated to be not connected with 'R' and 'M' in any manner, and yet the share subscriber had such a faith in the Taxpayer that it subscribed to the shares at an extremely high premium and that too without any management rights, which was quite unusual and suspicious. All this led to a conclusion that the investor company was acting as a conduit and shell company which was siphoning off money to other entities.

Therefore, the Tribunal rejected the Taxpayer's appeal and ruled in favour of the tax authorities since Taxpayer had failed to justify huge share premium received by it and the material on record did not provide the abovementioned transaction to be a regular transaction in normal course of business. Accordingly, relevant additions made by tax officer were considered to be justified.

On onus of proof the Tribunal held, and we quote as under:

*"There is no, and there cannot be any, dispute on the fundamental legal position that the onus is on the assessee to prove 'bona fides' or 'genuineness' of the share application money credited in his books of accounts."*

This Tribunal case (also a case before the proviso to Section 68 is applicable as the relevant year was AY 2011-12) has reiterated the position of the law that shell companies, irrespective of their form of existence, have to be analysed with respect to the substance of their activity. By holding that the transaction of share subscription was not genuine, the Tribunal emphasised on the fact that the burden of proof remains on the taxpayers to prove the genuineness.

In deciding this case the Tribunal (which is the final fact-finding authority in the appeal hierarchy) ignored Taxpayer's technical arguments like change of opinion, natural justice, source of information in

possession of the tax department, etc. and endeavoured to take a holistic approach giving credence to substance over form. The Tribunal also reiterated the findings from an earlier Supreme Court ruling to hold that it would be a superficial approach if it was expected of the alleged fraudster to prove so, as the fraudulent transaction could have taken place in secret and direct evidence of such deeds would be rarely available. These observations will have far reaching implications, and it will be interesting to see how the higher courts deal with this case as well as a lot of other similar cases.