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*   **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 19.03.2015
Pronounced on: 14.05.2015

+   **ITA 983/2006**

COMMISSIONER OF INCOME TAX, DELHI.........Appellant
Versus
M/S. VELOCIENT TECHNOLOGIES LTD.   ....Respondent

+   **ITA 1406/2006**

M/S. VELOCIENT TECHNOLOGIES LTD.   ....Appellant
Versus
COMMISSIONER OF INCOME TAX   ....Respondent

+   **ITA 1342/2009**

COMMISSIONER OF INCOME TAX   ....Appellant
Versus
VELOCIENT TECHNOLOGIES LTD.   ....Respondent

Through: Sh. Kamal Sawhney, Sr. Standing Counsel and Sh. Sanjay Kumar, Jr. Standing Counsel, for the Revenue.
Sh. Salil Aggarwal and Sh. Prakash Kumar, Advocates, for Velocient Technologies Ltd.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE R.K. GAUBA

MR. JUSTICE S. RAVINDRA BHAT

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1. The following questions of law arise in these three appeals:

(a) Whether the Income Tax Appellate Tribunal was correct both on facts and in law in upholding the assumption of jurisdiciton by the Assesing

Officer to frame an assessment by taking recourse to the provisions of Section 147 of the Income Tax Act, 1961? (AY 1993-94 - ITA 1406/2006)

(b) Whether the Income Tax Appellate Tribunal was correct both on facts and in law in deleting the addition of ₹10.65 crores made on account of unexplained cash credit under Section 68 of the Income Tax Act, 1961? (AY 1993-94 - ITA 983/2006)

(c) Whether the ITAT was correct in law in arriving at a conclusion that the amount of ₹10.65 crores was a loan in the hands of the assessee and not a trade advance and consequently its forfeiture did not constitute income chargeable to tax under the Income Tax Act, 1961?

(AY1996-97 - ITA 1342/2009)

2. The facts are that one M/s. Comecom Overseas (P.) Ltd. ("COPL") having its registered office at D-5, Kalindi, New Delhi and M/s. Sovfin-trade Overseas Ltd. (hereafter "SFT", a Company in the erstwhile USSR), entered into an agreement on 14-11-1991 to form a joint venture (JV) company called M/s. Eurolink Overseas (P.) Ltd. The purpose of the joint venture was production and development of computer software in India with equity participation of ₹70 lakhs, by both companies. M/s. Eurolink Overseas (P) Ltd's name was later changed to M/s. Velocient Technologies (P.) Ltd, the assessee. Besides equity participation, the Russian company had to advance a sum of ₹10.65 crores to the proposed joint venture. This amount was paid on two dates, by five remittances, i.e 20-11-1991 (3 payments aggregating ₹ 6.65 crores) and 27-11-1991 (two payments to the tune of ₹ 4 crores). The assessment was completed for 1993-94 after

examining the materials placed on record, on 29-03-1996 under Section 143 (3) by the Assessing Officer (AO).

3. Later, this amount was transferred from the books of COPL to Eurolink Overseas Private Ltd during FY 1992-93. The money was advanced by the Russian company for setting up of software development facility in India. According to the terms of the agreement, the Russian company was required to help the proposed joint venture company to: (a) set-up software development facility in India, (b) provide technical assistance, i.e., to depute their experts to help the Indian company in day-to-day operation, (c) procure the orders from Russia and other countries for the proposed joint venture for software development. The tenure of loan- under the agreement, was 5 years and no interest was chargeable for this period. Interest @ 6% p.a was payable after expiry of this period. Assessment was completed after inquiry, for AY 1993-94 in respect of the assessee.

4. During financial year 1995-96, the assessee forfeited the loan and credited the amount to Reserve Account. During the course of assessment proceedings (for the later year) the AO noticed the following facts:

(i) The agreement was made in November, 1991 to form the Joint Venture company, M/s. Eurolink Overseas Private Ltd. However, M/s. Eurolink Overseas Private Ltd. had already been incorporated in July 1991, i.e., even before the agreement was made.

(ii) SFT never contributed any equity capital in the assessee-company. The Indian partner, i.e., COPL also contributed only ₹ 2,000 towards the equity capital of the assessee-company as against the amount of ₹ 70 lakhs, i.e., the amount mentioned in the joint venture agreement. In fact, the total paid-up capital, till date, of the assessee-company is only ₹ 2,000, i.e., the joint venture never came into existence.

(iii) The assessee-company hardly ever carried on the business of software development.

(iv) The money received by way of loan of ₹ 10.65 crores was not utilized for the purpose of setting up of software development unit in India. Instead, the money was invested in another group concern, namely, M/s. Milestone Leasing & Finance (P.) Ltd. in the form of share capital.

5. A letter was written by the assessee-company on 23-6-1993. The gist of the letter is as under:

> *"You will appreciate that the project was put together based on your assurance about the buy-back and assured market concept. However, due to your failure to provide us software development opportunities we have landed ourselves in a situation whereby we may have to incur heavy loss during the current year and coming year, as we are constrained to look to other untapped markets, namely, USA and Far East.*
>
> *We, therefore, once again request you to kindly get as some valuable contracts from your associates and acquaintances. This way at least we will be able to sustain ourselves and your efforts will help us to make this project a grand success."*

Further, on 7-09-1993, 11-11-1993, January, 1994 and 07-03-1994 similar letters were written asking for business. In earlier years the assessee-company had also made export sales to SFT, the Russian company, indicative of trading transactions between the two companies. SFT however, did not respond to the letters of the assessee-company. The assessee stated that there was no communication from the side of SFT after the date of forfeiture of the loan. In view of these facts, the AO asked the assessee to explain why it should not be treated as business income under Section 28 of the Act since the alleged loan was in the nature of trade account, as it acquired the nature of trade surplus of the assessee-company with the efflux of time.

6. The assessee's position before the AO- for the later assessment year, when the loan was forfeited, was that the amount was a capital receipt, and the liability did not cease to be such by an act of unilateral forfeiture by it. It contended that for the AO to validly bring the amount to taxation, at the earlier stage, it should have been reflected as a trading receipt. The AO noticed that no interest was payable on the loan amount and that since SFT had not participated in the assessee's equity capital it (SFT) would not have derived any benefit by granting any interest-free loan. It was held that there was no interest or business expediency of advancing such huge interest-free loan to the assessee. The AO's view was that the only plausible explanation for advancing such huge amount to the assessee was that M/s. SFT gave the amount as advance for development and purchase of software from the assessee; based on the correspondence, the AO held that the alleged loan was nothing but a trade advance and not a simple loan transaction. The AO rejected the assessee's contention and held that ₹ 10.65 crores was income of the assessee under the head "Profit and gains of business or profession" chargeable to tax under Section 28 of the Act, by his order dated 28-03-2002

(the original assessment order was set aside by the Commissioner (Appeals) (hereafter "CIT (A)") on the ground of denial of proper opportunity).

7. During the pendency of the later assessment (AY 1996-97), in the light of the materials including correspondence between SFT and COPL the fact that SFT did not object or protest against forfeiture of liability – especially in the light of the statement of assessee's director Shri Nalin Aggarwal, a notice under Sections 147/148 was issued to the assessee, proposing to re-open the assessment for AY 1993-94. The assessee objected. In the re-assessment order the AO was of the opinion that the credibility of the agreement dated 14-11-1991 by which the advance was obtained itself was not explained satisfactorily. Noting that SFT did not participate in the equity capital of the assessee which had in fact been incorporated earlier, the AO held that there was no *rationale* for it to lend a huge amount of ₹ 10.65 crores to the assessee without any interest. It was also observed that the assessee could not establish that SFT existed or even furnish its address in the reassessment proceedings. The sum of ₹10.65 crores was received by COPL; the circumstances under which it was credited to the assessee were not established satisfactorily. It was therefore held that the amount was an unexplained receipt; the AO added it for AY 1993-94 and brought it to tax under Section 68 of the Income Tax Act, 1961 ("Act").

8. The regular assessment for AY 1996-97 and re-assessment order for AY 1993-94 were challenged before the Commissioner (Appeals) – i.e CIT (A). The CIT (A) by order dated 25-1-2006 rejected the appeal and held that the forfeited amount was to be brought to tax. For the earlier period (AY 1993-94, i.e the reassessment order) the inclusion under Section 68 was

likewise challenged in appeal to CIT (A), who rejected it. The revenue is in appeal, aggrieved by the ITAT's order in respect of the reassessment proceedings (on merits, which deleted the inclusion under Section 68 for AY 1993-94) and disallowance of forfeiture, for AY 1996-97. The assessee is aggrieved – not by the ITAT's findings on the merits, but rather for its upholding the re-opening of assessment (for AY 1993-94).

ITA Nos 1406/2006 & ITA 983/2006

9. The revenue argues that in the facts of this case, the AO was justified in invoking Section 68 of the Act. Here, it is urged that the re-opening of the assessment was warranted, despite the fact that the earlier assessment was completed under Section 143 (3). Counsel submitted that the assessee never furnished relevant particulars which could be reasonably verified as to the manner of transfer of funds. Highlighting the fact that the assessee itself was known as Eurolink Overseas Private Ltd, Mr. Kamal Sawhney for the revenue argued that the whole case for a loan made, was dubious. He stressed on various factors such as, firstly, that one of the equity partners, COPL contributed share capital only to the extent of ₹2,000/-; secondly, contrary to requirements of the Union Government, there was no equity payment in hard currency; thirdly, SFT – again contrary to the approval given by the Union Government, nowhere indicated that the remittance was for purposes of loan. Thirdly, the Reserve Bank's approval letter had directed the assessee to give details of utilization and the necessary details within a specified period, which was not followed; fourthly, equity infusion had not taken place by any of the parties, and certainly not to the extent of ₹70 lakhs by the two parties. Lastly the money had been diverted for other

use by the assessee. All these according to the counsel established that the loan transaction was never genuine to start with; consequently the AO was justified in re-opening the assessment, and adding the amount to the assessee's income.

10. Learned counsel relied on *Sumati Dayal v Commissioner of Income Tax* 214 ITR 801 (Del) to say that in view of section 68 of the Act, where any sum is found credited in the books of the assessee for any previous year, may be charged to tax as the assessee's income for that previous year if the explanation offered by him or her about the nature and source thereof is, in the opinion of the Assessing Officer, unsatisfactory. In such a case there is, *prima facie*, evidence against the assessee, viz., the receipt of money, and if he fails to rebut it, the said evidence being unrebutted, can be used against him by holding that it was a receipt of an income nature. He also submitted that the conditions for satisfying the onus placed on the assessee, as held in *Commissioner of Income Tax v. Lovely Exports P. Ltd.* [2009] 319 ITR 5 (SC) are not only the proof of identity of the share applicant or creditor, but also his creditworthiness and genuineness of the transaction. The facts shrouding the present case clearly highlighted that at the time the so-called loan was obtained, only the identity of SFT could be said to have been proved; no other material to establish the genuineness of the transaction or the creditworthiness of the party had been placed. Consequently, the ITAT fell into error in holding that Section 68 did not apply.

11. The revenue points out that *Diwakar Engineers Ltd. v. ITO* [2010] 329 ITR 28 (Delhi) and *Video Electronics v Joint Commissioner of Income Tax* 2013 (353) ITR 073 are authorities for the proposition that material

discerned by the assessing officer during the course of proceeding for subsequent years can be relevant and their sufficiency or adequacy (for completion of re-assessment) cannot be gone into while judging the validity of reassessment notice. *Phool Chand Bajrang Lal v Commissioner of Income Tax* 203 ITR 456 (SC) was particularly relied upon. In the said decision (*Phool Chand Bajrang Lal)* the Supreme Court held as follows:

> *"The present is, thus, not a case where the Income Tax Officer sought to draw any fresh inference, which could have been raised at the time of original assessment on the basis of the material placed before him by the assessee relating to the loan from the Calcutta Company and which he failed to draw at that time. Acquiring fresh information, specific in nature and reliable in character, relating to the concluded assessment which goes to expose the falsity of the statement made by the assessee at the time of original assessment is different from drawing a fresh inference from the some facts and material which was available which the I.T.O. at the time of original assessment proceedings. The two situations are distinct and different. Thus, where the transaction itself on the basis of subsequent information, is found to be a bogus transaction, the mere disclosure of that transaction at the time of original assessment proceedings, cannot be said to be disclosure of the "true" and "full" facts in the case and the I.T.O. would have the jurisdiction to reopen the concluded assessment in such a case."*

12. On the merits, it was argued that the revenue was entirely justified in reassessing the amounts received under Section 68 because the so-called foreign investor did not respond to any queries and no attempt or effort was made to secure its presence or view. Contending that reliance on the clearances received by other statutory authorities did not amount to establishing the genuineness or creditworthiness of the investor, counsel submitted that the infusion of a huge amount as loan on the one hand, not

using it for the purpose declared in the first instance, and not complying with the joint venture conditions clearly revealed that the amount bore the character of a receipt from undisclosed sources, liable to be assessed under Section 68.

13. Mr. Salil Agarwal who appeared for the assessee, in its appeal (ITA 1406/2006) impeached the reassessment notice, contending that firstly at no stage was the assessee furnished with the reasons that necessitated the re-opening of an assessment which had considered all the relevant materials, through searching enquiry. It was contended that the original assessment was completed in scrutiny proceedings; reliance was placed on the materials furnished by the assessee, including the clearances obtained from the statutory authorities for the purpose of the foreign company's joint venture, in the form of Reserve Bank clearance, approval by the authorities administering the laws relating to foreign exchange, etc. The money had been remitted through banking channels. All these were known; if there was anything wanting, it was not on the part of the assessee. Counsel relied on *Calcutta Discount Co. Ltd. v. ITO* [1961] 41 ITR 191 and stated that primary obligation of the assessee is to disclose fully and truly all material and relevant facts. The obligation being only to disclose basic facts but that would not include an obligation to disclose what inferences had to be drawn from such facts by the authorities. It was further observed that the production of all evidence before the AO was sufficient and it was not established that there was any omission or failure to make a full and true disclosure. The assessing officer had to make the necessary inferences

(which too had been done at the original stage when a searching scrutiny was resorted to) but no further duty was cast on the assessee.

14. Learned counsel relied on *Income Tax Officer v Lakhmani Mewal Dass* (1976) 103 ITR 437 (SC) where the Supreme Court held that:

> *"the reasons for the formation of the belief must have a rational connection with or relevant bearing on the formation of the belief. Rational connection postulates that there must be a direct nexus or live link between the material coming to the notice of the Income-tax Officer and the formation of his belief that there has been escapement of the income of the assessee from assessment in the particular year because of his failure to disclose fully and truly all material facts. It is no doubt true that the court cannot go into the sufficiency or adequacy of the material and substitute its own opinion for that of the Income-tax Officer on the point as to whether action should be initiated for reopening assessment. At the same time we have to bear in mind that it is not any and every material, howsoever vague and indefinite or distant, remote and far-fetched, which would warrant the formation of the belief relating to escapement of the income of the assessee from assessment. The fact that the words "definite information" which were there in section 34 of the Act of 1922, at one time before its amendment in 1948, are not there in section 147 of the Act of 1961, would not lead to the conclusion that action can now be taken for reopening assessment even if the information is wholly vague, indefinite, far-fetched and remote. The reason for the formation of the belief must be held in good faith and should not be a mere pretence.*
>
> *The powers of the Income-tax Officer to reopen assessment, though wide, are not plenary. The words of the statute are "reason to believe" and not "reason to suspect". The reopening of the assessment after the lapse of many years is a serious matter. The Act, no doubt, contemplates the reopening of the assessment if grounds exist for believing that income of the assessee has escaped assessment. The underlying reason for that is that instances of concealed income or other income escaping assessment in a large number of cases come to*

> *the notice of the income-tax authorities after the assessment has been completed. The provisions of the Act in this respect depart from the normal rule that there should be, subject to right of appeal and revision, finality about orders made in judicial and quasi-judicial proceedings. It is, therefore, essential that before such action is taken the requirements of the law should be satisfied. The live link or close nexus which should be there between the material before the Income-tax Officer in the present case and the belief which he was to form regarding the escapement of the income of the assessee from assessment because of the latter's failure or omission to disclose fully and truly all material facts was missing in the case. In any event, the link was too tenuous to provide a legally sound basis for reopening the assessment."*

15. The assessee's counsel argued that in the circumstances, the addition on the ground of unexplained income was unsustainable. He relied on the joint venture agreement dated 14-11-1991; MOU of the same date, copy of foreign collaboration approval by Department of Industrial Development dated 15-06-1992; copy of approval given by Department of Economic Affairs on 29-10-1992 and the Reserve Bank Exchange Control Department approval dated 11-12-1992. All these clearly established that SFT was a genuine Soviet Government undertaking which had remitted the money to COPL. Most importantly the Certificate of Foreign Inward Remittance issued by the Punjab National Bank (PNB) whenever SFT credited money to COPL was also produced. Evidence of export, in the form of airway bills, whenever goods were consigned abroad too were relied upon. Since all the amounts were received through normal banking channels and in support of the transaction, fortunately there was extensive material establishing its genuineness, the addition under Section 68 based on a later unrelated event, i.e premature forfeiture of the loan, was not justified.

16. Learned counsel relied on the documents placed on record of the assessment proceedings and the appeal before the ITAT to contend that the AO did not examine the record; had he done so, it would have been apparent that not only was the material relied on in re-assessment proceeding not different from what was relied on originally, but even that the AO had directed material and relevant queries in the original proceeding. Reliance was placed on copies of the MOU with SOFL dated 14-11-1991 and the Department of Industrial Development, Government of India approval for the arrangement through its letter dated 15-06-1992. It was submitted that the AO's queries dated 29-06-1995 showed that the precise question as to the unsecured loan was the subject matter of scrutiny; for this the assessee had furnished all relevant particulars in a letter dated 22-08-1995. Apart from RBI approval for the foreign exchange transaction, the Department of Electronics clearance through letter dated 24-12-1991 was also shown. The details of remittances received towards the loan, on various dates, i.e 20-11-1991 and 27-11-1991 were also shown. In these circumstances, the question of re-opening of assessment could not arise. Lastly counsel relied on Note 7 to the Notes on Account, to say that proper and true disclosure had been made which enabled the AO to make inquiries. The said Note reads as follows:

> *"An Unsecured Loan of Rs. 10.65 crores has been received from a foreign company pursuant to an Agreement for setting up a joint venture Project in India for export of Computer Software. Necessary Permission and licenses have been obtained for setting up of the Project from concerned authorities."*

Also, the lower authorities erred in holding that the amount deserved to be brought to tax, on the merits. The ITAT's order, however is sound, as it held that the addition could not have been made on the merits.

Analysis & Findings

17. The AO, framed the original order, under Section 143 (3) after observing as follows:

> *"M/s SFT agreed to grant loan to the joint venture, called Eurolink by mutual consent and both parties agreed that SFT shall transfer the loan amount to COPL account in India prior to the commencement of filing for any approvals from Dept. Electronics & RBI for this business."*

18. The matter had been remanded by the CIT (A) when the AO became aware of the forfeiture of the loan. This led to the opinion formation- for the purpose of reassessment. The re-opening has been questioned by the assessee, contending that there was no material, that it was not informed about the reasons and that even otherwise, there was no failure to disclose material facts in the first instance, which could have led to a valid re-opening of the assessment for the year. On merits too, the assessee contends that there is no valid basis for holding that the source of the funds was unknown, or doubting the credibility of the source. It is argued that the assessee cannot be placed in an impossible situation of having to prove or establish the "source of the source" as has been done by the revenue in this case.

19. *Phool Chand Bajrang Lal* (supra) is an authority for the proposition that acquisition of *"fresh information, specific in nature and reliable in character, relating to the concluded assessment"* which exposes *"falsity"* of the assessee's statement during the original statement is a legitmate basis for

re-opening (the asssessment). The court significantly noted that *"the mere disclosure of that transaction at the time of original assessment proceedings, cannot be said to be disclosure of the "true" and "full" facts in the case and the I.T.O. would have the jurisdiction to reopen the concluded assessment in such a case."* That decision had taken note of *Lakhmani Mewal Dass* and *Calcutta Discount* (supra). This court also notes that the subsequent ruling of a three judge bench of the Supreme Court in *Commissioner of Income Tax v Kelvinator India Ltd* (2010) 320 ITR 561 (SC) crystallizes the acceptable standard for upholding a reassessment notice (under Section 147/148) as something beyond the existing record, in the form of *"tangible material"* available to the AO which provides a *"live link"* to the formation of a legitimate belief that reassessment is called for. In the present case, the formation of opinion is recorded in the note (i.e "reasons to believe") dated 30-03-2001 which noted that for AY 1996-97, the forfeiture of the loan was treated as cessation of trading liability and that even in its submissions before CIT (A) the assessee *"failed to establish the truthfulness of its claim of the receipt of loan of Rs. 10.65 crores despite being afforded specific opportunities. The CIT (A) also in his order has not commented on the veracity of the evidence furnished by the assessee in this regard…the assessee was not able to accurately and specifically establish the fact that this money indeed belonged to the Russian Company nor the reason for the unilateral forfeiture as discussed in the earlier paras."* Now, these facts facially were sufficient, in the light of the ruling in *Phool Chand* and *Kelvinator* (supra) for the AO to form a valid opinion that reassessment was necessary. The judgment in *Honda Siel Power Products v. Dy. CIT* (2012) 340 ITR 53 (Del) of this court is authority to say that the term 'failure' on the part of the assessee is not restricted to the income-tax return and the columns of the income-tax return or the tax audit report. The court held that the expression *"failure to fully and truly disclose material facts"* also relates to the stage of the assessment proceedings and that there can be omission and failure on the part of the assessee to disclose material facts fully and truly during the course of the assessment proceedings.

20. As far as the assessee's complaint of not being made aware of the "reasons to believe" or opinion for reassessment is concerned, the argument proceeds on a misconception. The Act does not stipulate furnishing of reasons to the assessee; this condition was superadded, when the assessee, seeks such opinion and wishes to represent against it, *after* furnishing his/her returns upon the receipt of notice, by virtue of the order of the Supreme Court in *GKN Driveshafts (India) Limited v. Income Tax Officer and Others* (2003) 1 SCC 72. In the facts of the present case, such condition did not exist nor was sought for when the reassessment notice was issued to the assesse in 2001. The law, in this context was stated by the Supreme Court, as follows, in *R.K. Upadhyaya v Shanabhai P. Patel* AIR 1987 SC 1378:

> *"Section 34, conferred jurisdiction on the Income-tax Officer to reopen an assessment subject to service of notice within the prescribed period. Therefore, service of notice within limitation was the foundation of jurisdiction. The same view has been taken by this Court in Janni v. Indu Prasad Bhat, 72 ITR 595 as also in C.I.T. v. Robert, 48 ITR 177. The High Court in our opinion went wrong in relying upon the ratio of 53 ITR 100 in disposing of the case in hand. The scheme of the 1961 Act so far as notice for reassessment is concerned is quite different. What used to be contained in section 34 of the 1922 Act has been spread out into three sections, being sections 147, 148 and 149 in the 1961 Act. A clear distinction has been made out between 'issue of notice' and 'service of notice' under the 1961*

> *Act. Section 149 prescribe the period of limitation. It categorically prescribes that no notice under section 149 shall be issued after the prescribed limitation has lapsed. Section 148(1) provides for service of notice as a condition precedent to making the order of assessment. Once a notice is issued within the period of limitations, jurisdiction becomes vested in the Income-tax Officer to proceed to reassess. The mandate of section 148(1) is that reassessment shall not be made until there has been service. The requirement of issue of notice is satisfied when a notice is actually issued. In this case, admittedly, the notice was issued within the prescribed period of limitation as March 31, 1970, was the last day of that period. Service under the new Act is not a condition precedent to conferment of jurisdiction in the Income-tax Officer to deal with the matter but it is a condition precedent to making of the order of assessment. The High Court in our opinion lost sight of the distinction and under a wrong basis felt bound by the judgment in 53 ITR 100. As the Income-tax Officer had issued notice within limitations, the appeal is allowed and the order of the High Court is vacated."*

Thus, we are of the opinion that the assessee's arugments with respect to justification for re-opening of assessemnt in this case are unmerited. The question of law argued by it in that context is answered against it. ITA No. 1406/2006 consequently fails.

21. The next question concerns the merits of the addition of ₹10.65 crores made during reassessment proceedings. The AO's order was upheld by the CIT (A) and disturbed by the ITAT. The revenue contends here that the ITAT was considerably taken in by the assessee's submission that no fresh materials were used in the reassessment proceedings which was premised primarily upon a subsequent event, i.e forfeiture of loan by the Russian company during a later assessment year. It is submitted that the original returns did not disclose how the Russian creditor had genuinely loaned a substantial amount. Though the assessee had obtained and placed on record

clearances from statutory bodies and authorities, based on the Joint Venture agreement dated 14-11-1991 between COPL and SFT, the preconditions for use of such amount were never fulfilled. Thus, the assessee was already incorporated before the date of that agreement – in fact, in July, 1991. It had a subscribed share capital of ₹2,000/- and the agreement provisions requiring infusion of ₹70 lakh share capital by the Russian company were in fact never fulfilled. Also, significantly the assessee never revealed that the share participation proposal was not given sanction by the RBI- which had turned it down in the original terms. Had these materials been truthfully revealed, the AO would have undertaken a detailed scrutiny and not allowed the assessee to bring the said amount, without enquiry. In reply, the assessee submits that all materials necessary for deciding the identity of the Russian creditor (a USSR Government company) and the creditworthiness of the transaction were made known. The AO had made furhter inquiries during the assessment and after due satisfaction, held that the amount could not be taxed. The reassessment proceedings and addition was nothing but an impermissible review of the previous AO's order framing the assessement for the year.

22. This court notices that according to the material furnished by the assessee:

(i) The original intent between COPL and SFT in 1990 was that the former or a new entity would be set up for implementing a project whereby ₹6.3 crores would be provided as term loan (LOI dated 7-12-1990 between COPL and SFT). This led to RBI's approval being sought on 18-12-1990 for a term loan to be kept in a separate account from which there could be no withdrawal.

(ii) RBI, in its letter dated 17-01-1991 permitted COPL to receive the said amount on the condition that no withdrawal was permitted without its special approval.

(iii) These events were followed by the arrangement of November 1991 for setting up a joint venture , i.e Eurolink. SFT could unilaterally withdraw the credit after 5 years.

(iv) The assessee contended that SFT pre-empted all Central Government approvals by remitting ₹35 lakhs towards equity and ₹10.30 crores as loan on 20-11-1991 and subsequent dates. This was followed by another agreement for repayment with interest @ 6 % per annum.

(v) On 15-06-1992, the Secretariat for Industrial Approval, Union Finance Ministry approved foreign collaboration subject to condition that equity contributed loan was to be made in hard currency only. Later, EC Division approved the entire loan of ₹10.65 crores.

23. Both the AO and the CIT (A) noted that the assessee company had already been incorporated in July 1991, *before* the Agreement between SFT and COPL. Furthermore, the assessee company had a meagre share capital contribution of ₹2000/- by COPL and none by SFT. Its books, when the amounts were transferred, showed the liability (for 1993-94 and the next year). However, what was not revealed was how, with the limited RBI approval on 17-01-1991 for a term loan to be kept in a separate account

from which there could be withdrawal after specific approval, the arrangement could be transformed into one where the amount was received *not by the assessee, but by COPL which handed it over to the assessee*.

24. In the original assessment proceedings, the returns filed included a confirmation from COPL for the money received as advance towards share application money (in respect of four payments made by cheque to the tune of ₹19,50,000/-); a copy of the joint venture agreement between COPL and SFT dated 14.11.1991, the memorandum of understanding between the said two parties, again dated 14.11.1991 and the addendum to the agreement dated 28.11.1991. Besides, the copy of the approval from the Government of India dated 15.06.1992 which was valid for two years and required the assessee to furnish the collaboration agreement with the RBI subsequently, and the Union Ministry of Finance's approval dated 29.10.1992, permitting the loan for ₹10.65 crores was made part of the record. In the letter dated 29.09.1994, the assessee's auditor stated that the said amount was received from a foreign company pursuant to agreement for setting-up joint venture project in India for export of computer software and that necessary permissions and licenses had been obtained.

25. In the course of assessment proceedings, the assessee was asked to provide details of unsecured loans with confirmation letters and source of investment. In reply, the auditor on 22.08.1995 relied upon a copy of the agreements (of November, 1991 between COPL and STF), the Union Department of Electronics's letter dated 24.12.1991 and the RBI permission in respect of the loan, through its letter dated 11.12.1992. It is thus evident that at no point of time did the assessee in fact furnish any details or

particulars with respect to the Soviet Russian Company, i.e. SFT, which according to it primarily advanced the money – through COPL. Furthermore, the identity of COPL too was never revealed. Only four documents were relied upon in connection with these entities – three of them dated 14.11.1991 in the form of *inter se* agreements between the two and a Resolution of the same date, i.e. 14.11,1991. The loan letter by COPL was in respect of the sum of ₹19.5 lakhs remitted by it. Whether these two entities were actually controlled by the erstwhile Government of USSR or were established by third parties; what was their economic activity was never revealed. COPL in fact was described as a private company incorporated in Delhi with registered office at D-5, Kalindi, New Delhi. No attempt was made to explain the *inter se* relationship between COPL and SFT, and why the former was convenient as a source for financing the software development project of an already established company. If indeed, the money came in through *because* of the joint ventureagreement, why SFT and COPL could not name M/s Eurolink Overseas Private Ltd (an existing and incorporated company) as the recipient, was never explained. The materials on record and submissions made, both in the course of assessment and re-assessment proceedings, do not, in any way satisfactorily explain the identities of these Russian companies and whether they genuinely lent monies as claimed by the assessee.

26. The Supreme Court's ruling in *CIT v. Lovely Exports* 2010 (14) SCC 761 affirms the ruling of this Court that to pass the test of Section 68 which empowers the income tax authorities to add back amounts as receipts from undisclosed sources, the assessee is under the initial onus of proving the

genuineness of the transaction and the creditworthiness of the individual/entity advancing the amount. In the present case, the facts reveal that the assessee no doubt was able to secure the clearances of the Department of Economic Affairs as well as the Reserve Bank of India (RBI) towards its software technology project. These were based upon its assertion that Russian joint venture partners were involved. Likewise, the Department of Economic Affairs appear to have approved the setting-up of the project. Nevertheless, such clearances did not in any way undermine or displace the onus which it continued to labour under, to primarily satisfy the revenue that the amounts came from a genuine party. There were no particulars with respect to SFT or COPL, the documents incorporating these entities or even describing their identities (especially important since the assessee argued that SFT was a Govt. of USSR enterprise) was ever revealed. Those two companies' shareholding pattern, trading or manufacturing activities, decision of Board of Directors was kept in the dark. In short, the assessee made no attempt to reveal the true identity of these two concerns. Furthermore, the credibility of these transactions too stood undermined from the very beginning considering that COPL's role *vis-a-vis* SFT was never explained. It was not SFT which gave the money to the assessee. Therefore, the onus to prove that the amounts came from credible sources and creditworthiness of the entity or the source, was never discharged.

27. In view of the above reasons, this Court is of the opinion that the findings recorded by the AO and the CIT(A) were sound and based upon a correct appraisal of the entirety of the circumstances. The ITAT fell into error in not following the established principles governing the law of Section

68 of the Act. The findings in the impugned order are accordingly set-aside. The sole question of law in ITA 983/2006 is answered in favour of the revenue and against the assessee.

ITA 1342/2009

28. The facts concerning the question of law in this appeal are that the sum of ₹10.65 crores had been forfeited for AY 1996-97. As discussed in the earlier part of this judgment in answer to Question nos. 1 and 2, the amount was initially shown as loan in AY 1993-94. For AY 1996-97, the assessee declared – in its return dated 30.11.1996, a loss of ₹22,04,997/-. Scrutiny assessment was completed on 30.03.1999, after adding ₹10,65,00,599/-. The assessee's appeal was allowed and the matter was remitted by the CIT(A) directing AO to grant sufficient opportunity (to the assessee). In the assessment subsequently completed on 28.03.2002, the AO noticed the previous facts leading to the advancement of the amount, the change of name of M/s. Euro Link Private Limited to M/s. Velocient Technologies Private Limited, the various dates of receipt of the amount towards software development facilitation through a project in India etc. The AO relied upon a letter written by the assessee, dated 23.06.1993, soliciting contracts; he also noted that as against commitment to contribute equity capital to the tune of ₹70 lakhs, COPL had originally paid only ₹2000 and that the amount of ₹10.65 crores was not utilized for the original purpose but was invested in another concern, M/s. Milestone Leasing and Finance Company. Doubting the forfeiture claimed by the assessee, the AO observed that in fact he never responded to the letters and was consequently asked why such forfeiture should not be treated as business expenditure under

Section 28. The assessee relied upon the Supreme Court's ruling in *T.V. Sundaram Iyengar v. CIT* 1996 (222) ITR 324, to say that where in the books, the assessee claims a trading receipt, its subsequent conversion is impermissible but that in the present case, what was received was a loan and could not be treated as income.

29. The ITAT noted that in the assessee's books of accounts for 1993-94, the said amount of ₹10.65 crores was shown to be a loan from SFT but in the year under consideration, the amount was forfeited by transferring it to the reserve account. The ITAT noted that even while remanding the order, the CIT(A) on 31.03.2000 had rejected the AO's original action treating profit as chargeable tax under Section 41(1) on the ground that it had never been allowed as deduction or allowance in the earlier year which was a pre-condition for application of that provision. After discussing various decisions, rendered prior to *T.V. Sundaram Iyengar (supra)*, the ITAT held that the principle which emerged was that the amount received by assessee as part of its trading operations or transactions though it is not taxable in the year of receipt being a revenue character it would undergo a change in character when it becomes that of the assessee, due to operation of law of limitation or by statutory mandate or by exercise of contractual right in which event common sense dictates that it should be treated as income. After noticing various factual details with respect to how the money was received and treated initially in the books of the assessee, including the approvals granted by the statutory authority and the RBI, the ITAT held:

> *"………….The aforesaid amount was ultimately forfeited by the assessee and transferred to the reserve account. On an application made by the*

assessee company, the Department of Economic Affairs (ECB Division), Ministry of Finance, Govt. of India has intimated the assessee that his department has no comment with regard to the grant of permission to forfeit the loan amount and the assessee was advised to take up the matter with RBI accordingly.

38. It has been noted by the AO that the joint venture agreement was entered into November, 1991 though the assessee company had already incorporated in July, 1991. Further, SFT never contributed any equity capital in the assessee company though it was agreed in the joint venture agreement that SFT would contribute an amount of 70 lacs towards share capital on the assessee. The India partner to the joint venture agreement contributed only Rs.2000/- as against the amount of 70 lac in the share capital of the assessee company. The AO has also given a finding that the assessee company hardly ever carried on the business of software development and the money received towards alleged loan of Rs.10.65 crore was not utilized for the purpose of software development of India. The AO and the CIT(A) has treated the alleged loan amount as a trade advance, and, in this connection, they made a reference to the correspondence made by the assessee company with SFT in its letter dated 23-06-1993.....

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.............The crux of the requirement to treat the alleged loan as assessee's income on its forfeiture that the money must be received in the course of trading transaction or the money had arisen out of ordinary trading transactions is totally lacking in the present case. The assessee's subsequent reminders given to SFT to provide it some software development opportunities by giving some valuable business contracts from prospective buyers do not alter the original character being of loan granted to the assessee and is not sufficient to treat the same as a trade advance received in this course of any trading transaction, or as the money arising out of ordinary trading transactions. In the light of the above, the contention of the department that the assessee had received the sum of Rs.10.65 crore as a trade advance in the course of trading transactions is rejected. The loan so received by the assessee was for the purpose of setting up a business of software development in India and was not at all related or connected

> *to any trading transactions of the assessee company. Thus, the basic and primary criteria laid down in the case of CIT v. T.V. Sundaram Iyengar and Sons Ltd. (SC) (supra), that the money should be received in the course of trading transactions or the money had arisen out of ordinary trading transactions for treating the same as income of the assessee because of limitation or any other statutory or contractual right or forfeiture or waiver, is not satisfied in the present case. Merely because of the reason that the money has been forfeited by the assessee by transferring the same to its reserve and surplus account with satisfying the primary and basic condition that the money when it was received was received in the course of trading transaction or the money had arisen out of the ordinary trading transactions of the assessee company, the same cannot be considered to be income of the assessee chargeable to tax under the Act on its forfeiture. In the instant case, as observed above, the basic and primary requirement that the sum of Rs.10.65 crore should be received in the course of trading transactions or it had arisen out of the ordinary transactions, is not satisfied, and as such the decision in the case of CIT v. T.V. Sundaram Iyenger and Sons Ltd. (SC) (supra) would not help the revenue's case to brought the said sum to tax in the hands of the assessee.......”*

30. The ITAT's reasoning, according to us, is sound and based on established principles. Firstly, Section 41(1) which empowers the Revenue to treat the amounts claimed one way or the other in the previous years as the assessee's income, and bring it to tax, relates to deductions made *“for any year in respect of loss, expenditure or trading loss”*. The second important aspect is that the mere change of character of the amounts in the books of the assessee is undeterminative as to whether it can be brought to tax under Section 41(1). *T.V. Sundaram (supra)* was a case where unclaimed sundry balances lying with the assessee could have been treated as trading receipts. There the amounts were lying with the assessee and the customer's claims were barred by limitation. The amounts were transferred to the P&L account. The revenue held that the moneys were received in the course of

trading transactions. The crucial difference was that though the original amounts received were not income, by lapse of time, the depositors' claims had become time-barred and due to this statutory interdict, the amount acquired a different character. In the present instance, no such supervening event took place. By no stretch of imagination could the initial amount of ₹10.65 crores have been treated as loss, expenditure or trade liability incurred during the previous year. No doubt, the circumstances whereby the assessee forfeited the amounts raised certain suspicions. As explained earlier, those suspicions led to the reopening of the previous year's assessment and completion of reassessment by adding those amounts under Section 68. Both *T.V. Sundaram (supra)* and the judgment in *Punjab Distilling Industries v. CIT* AIR 1959 SC 346 rely upon the decision in *Morley v. Tattersall* 1938 (22) Tax Cas 51. The Supreme Court however, held that once amounts are shown as trading receipts, they contain a profit making element within them. The subsequent treatment, therefore, could well attract compulsion dictated by law, i.e. their inclusion for the later year. In the present case, the amounts were never treated as trading receipts but as unsecured loans – no doubt for the purpose of establishing or furthering a business, yet they were loans and not trading receipts or loss from expenditure – the other instances attracting Section 41(1).

31. For AY 1996-97, independent of the findings with respect to treatment for earlier year as unaccounted receipt under Section 68, given the phraseology and wording of Section 41(1), the Revenue's arguments for the latter's applicability are without substance and merit.

32. In view of the foregoing conclusions, the ITAT's impugned order for AY 1996-97 (in ITA 1342/2009) does not call for interference. The question of law framed in ITA 1342/2009 is answered against the revenue and so the appeal has to fail.

33. In view of the above discussion, ITA 983/2006 has to succeed and is accordingly allowed. ITAs 1406/2006 and 1342/2009 consequently, for the same reasons, fail and are dismissed. There shall be no order as to costs.

HIGH COURT OF DELHI
सत्यमेव जयते

S. RAVINDRA BHAT
(JUDGE)

R.K. GAUBA
(JUDGE)

MAY 14, 2015