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Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes

Date 10.01.2018

To:
All Pr. Chief Commissioners of Income Tax
All Chief Commissioners of Income Tax-Central
All Directors General of Income Tax (Inv.)
All Chief Commissioners of Income Tax-International Tax
The Chief Commissioner of Income Tax-Exemptions

Madam/Sir,

Subject:- Standard Procedure for applying provisions of section 68 of Income tax Act, 1961 -reg.

Assessing Officers should follow the sequence as noted below for applying provisions of section 68 of the Act:

- SOP-68
No. MSS
PL
- X
- Step 1:** Whether there is credit of a sum during the year in the books of accounts maintained by the taxpayer.
 - Step 2:** If yes, the assessee should be asked to explain the nature and source of such credit appearing in the books of accounts of the assessee.
 - Step 3:** If the assessee offers no explanation, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.
 - Step 4:** If the assessee furnishes an explanation, the AO should examine whether the explanation so offered establishes the three ingredients i.e. identity of the creditor, creditworthiness of the creditor and genuineness of the transactions.
 - Step 5:** Whether explanation of the assessee is reliable or acceptable? If yes, no further action is required and the sum so credited may not be charged to income tax.
 - Step 6:** If the explanation so offered by the assessee is not acceptable or reliable, the AO should give a detailed reasoning in the assessment order for not accepting the same.
 - Step 7:** The reasons for not accepting the explanation of the assessee should be communicated to the assessee.
 - Step 8:** The order passed by the AO should be speaking one bringing on record all the facts, explanation furnished by the assessee in respect of nature and source of the credit in its books of accounts and reasons for not accepting the explanation of the assessee. Relevant case laws should be relied upon wherever possible.

The above questions are not exhaustive but illustrative and the questions and sequence may vary depending upon facts of each case.

The above procedure be brought to the notice of all officers working under your jurisdiction for compliance.

Sunita Verma
10-1-10
Sunita Verma
Director (A&PAC)
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Enclosure:

1. Background Note to section 68 along with some important case laws for reference.

Background note to section 68 of the Act

Section 68 of the Act reads as under:

"Where any sum is found credited in books 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 :

[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.]"

1.1 From the reading of section 68, following conditions can be stated to be met for the applicability of section 68:

- i. Assessee has maintained 'books'
- ii. There has to be credit of amounts in the books maintained by the taxpayer of a sum during the year.
- iii. The taxpayer offers no explanation about the nature and source of such credit found in the books or the explanation offered by the taxpayer in the opinion of the Assessing Officer is not satisfactory.
- iv. If the taxpayer is a closely held company 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 company shall be deemed to be not satisfactory, unless [As amended by Finance Act, 2012, w.e.f.1.4.2013]:
 - (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 has been found to be satisfactory.

If all the above conditions exist, sum so credited may be charged to tax as income of the taxpayer of that year.

2. **Meaning of the term "books"**

- i. The term 'books' of the assessee maintained for any previous year has invited judicial scrutiny by various courts with reference to what constitutes "books". The Hon'ble Supreme Court in **Shri V.C. Shukla v. CBI [1998] 3 SCC 410** has discussed the meaning of the term "books":

"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.

- ii. The term "books of Account" was inserted by the Finance Act, 2001, w.e.f. 1-6-2001 u/s 2(12A) of the Act:

"books or books of account" includes ledgers, day-books, cash books, account-books and other books, whether kept in the written form or as print-outs of data stored in a floppy, disc, tape or any other form of electro-magnetic data storage device;"

3. **Burden of proof- Explanation of the assessee:**

The expression "the assessee offers no explanation" has been analysed by Hon'ble Supreme Court in various cases. Relevant portion from following case laws are extracted below:

- i. **CIT v. P. Mohanakala [2007] 161 Taxman169 (SC) 161 Taxman169 (SC)**

"The expression "the assessee offer no explanation" means where the assessee offer no proper, reasonable and acceptable explanation as regards the sums found credited in the books maintained by the assessee. It is true the opinion of the Assessing Officer for not accepting the explanation offered by the assessee as not satisfactory is required to be based on proper appreciation of material and other attending circumstances available on record. The opinion of the Assessing Officer is required to be formed objectively with reference to the material available on record. Application of mind is the sine qua non for forming the opinion".

- ii. **Kale Khan Mohammad Hanif v CIT[1963] 50 ITR 1 (SC)**

"It is well established that the onus of proving the source of a sum of money found to have been received by the assessee is on him. If he disputes liability for tax, it is for him to show either that the receipt was not income or that if it was, it was exempt from taxation under the provisions of the Act. In the absence of such proof, the Income-tax Officer is entitled to treat it as taxable income".

iii. **Sumati Dayal v. CIT [1995] 80 Taxman 89 (SC)**

"But, in view of Section 68 of the Act, where any sum is found credited in the books of the assessee for any previous year the same may be charged to income tax as the income of the assessee of that previous year if the explanation offered by the assessee about the nature and source thereof is, in the opinion of the Assessing Officer, not satisfactory. In such case there is, prima facie, evidence against the assessee, viz., the receipt of money, and if he fails to rebut, the said evidence being unrebutted, can be used against him by holding that it was a receipt of an income nature. While considering the explanation of the assessee the Department cannot, however, act unreasonably.

iv. **Smt. Sreelekha Banerjee v CIT (1963) 49 ITR 112 (SC)**

"It seems to us that the correct approach to questions of this kind is this. If there is an entry in the account books of the assessee which shows the receipt of a sum or conversion of high denomination notes tendered for conversion by the assessee himself, it is necessary for the assessee to establish, if asked, what the source of that money is and to prove that it does not bear the nature of income. The Department is not at this stage required to prove anything. It can ask the assessee to bring any books of account or other documents or evidence pertinent to the explanation if one is furnished, and examine the evidence and the explanation. If the explanation shows that the receipt was not of an income nature, the Department cannot act unreasonably and reject that explanation to hold that it was income. If, however, the explanation is unconvincing and one which deserves to be rejected, the Department can reject it and draw the inference that the amount represents income either from the sources already disclosed by the assessee or from some undisclosed source. The Department does not then proceed on no evidence, because the fact that there was receipt of money, is itself evidence against the assessee. There is thus prima facie evidence against the assessee which he fails to rebut, and being unrebutted, that evidence can be used against him by holding that it was a receipt of an income nature. The very words "an undisclosed source" show that the disclosure must come from the assessee and not from the Department".

v. **Vijay Kumar Talwar v CIT (2011) 330 ITR 1 (SC)**

"22. Examined on the touch-stone of the afore-noted legal principle, we are of the opinion that in the instant case the High Court has correctly concluded that no substantial question of law arises from the order of the Tribunal. All the authorities below, in particular the Tribunal, have observed in unison that the assessee did not produce any evidence to rebut the presumption drawn against him under section 68 of the Act, by producing the parties in whose name the amounts in question has been credited by the assessee in his books of account. In the absence of any cogent evidence, a bad explanation

furnished by the assessee about the source of the credits in question, viz., realisation from the debtors of the erstwhile firm, in the opinion of the Assessing Officer, was not satisfactory. It is well settled 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, the same may be charged to income tax as the income of the assessee that the previous year, if the explanation offered by the assessee about the nature and source thereof is, in the opinion of the Assessing Officer, not satisfactory (see Sumati Dayal v CIT [1995] supp (2) SCC 453 and CIT v. P. Mohanakala [2007] 6 SCC 21)."*

4. Ingredients of the assessee's onus:

Hon'ble Kerala High Court in case of **M.A. Unneeri Kutty v CIT (1992) 198 ITR 147, 150 (Ker.)**, [SLP dismissed by Hon'ble Supreme Court: (1993) 201 ITR (st.) 23] while examining ingredients of assessee's onus has held as under:

*"It cannot be doubted that it is for the assessee to prove **the identity** of the creditor as also the **creditworthiness**. The **genuineness** of the transactions should be proved.*

In view of the above decisions, the explanation offered by the assessee must have the above 3 ingredients:

- i. **Identity of the creditor**
- ii. **Creditworthiness of the creditor i.e. capacity of the creditor to advance the money**
- iii. **Genuineness of the transactions**

Once the assessee has proved the above three ingredients simultaneously and adduce evidence to establish prima facie the aforesaid, the onus shifts on the Department.

4.1 From a careful perusal of the above decisions of Hon'ble Supreme Court, it is established that primary onus to prove identity of creditors, capacity of such creditor to advance the money and the genuineness of the transaction is on the assessee. The Hon'ble Supreme Court has further held that explanation offered by the assessee should be carefully examined by the AO to ascertain whether all the ingredients of the onus are proved by the assessee or not.

5. Applicability of section 68 in cases of "accommodation entry" in respect of share application money/share premium

The earlier view of Hon'ble Delhi High Court in the cases **Stellar Investment Ltd. 192 ITR 287** and **Lovely Exports Pvt Ltd , 299 ITR 268** was that share capital cannot be added in the hands of the assessee company once the assessee furnishes PAN, addresses of the creditor/subscriber along with copies of the shareholders register, share application forms, share transfer register, etc. This would constitute sufficient explanation by the assessee. The Hon'ble Supreme Court was in agreement with above decisions of Delhi High Court; however, on conclusion of facts only without answering the ratio laid down as sought to be pronounced by Delhi High Court [Ref: **Hindustan Tea Trading Co.Ltd. vs CIT 263 ITR 289 (Kol)**].

6. However, subsequently, the above decisions of the Hon'ble Supreme Court and Delhi High Court have been considered by various Courts including Delhi High Court itself. Based on the findings of facts and detailed investigations, these courts have distinguished the observations of the Hon'ble Supreme Court in Stellar Investment Ltd and Lovely Exports Pvt Ltd and have upheld the invoking of section 68.

i. **CIT v. Nova Promoters and Finlease (P.) Ltd. [2012] 342 ITR 169 (Delhi)**

"The ratio of a decision is to be understood and appreciated in the background of the facts of that case. So understood, it will be seen that where the complete particulars of the share applicants such as their names and addresses, income tax file numbers, their creditworthiness, share application forms and share holders' register, share transfer register etc. are furnished to the Assessing Officer and the Assessing Officer has not conducted any enquiry into the same or has no material in his possession to show that those particulars are false and cannot be acted upon, then no addition can be made in the hands of the company under sec.68 and the remedy open to the revenue is to go after the share applicants in accordance with law. We are afraid that we cannot apply the ratio to a case, such as the present one, where the Assessing Officer is in possession of material that discredits and impeaches the particulars furnished by the assessee and also establishes the link between self-confessed "accommodation entry providers", whose business it is to help assesseees bring into their books of account their unaccounted monies through the medium of share subscription, and the assessee. The ratio is inapplicable to a case, again such as the present one, where the involvement of the assessee in such modus operandi is clearly indicated by valid material made available to the Assessing Officer as a result of investigations carried out by the revenue authorities into the activities of such "entry providers". The existence with the Assessing Officer of material showing that the share subscriptions were collected as part of a pre-meditated plan- a smokescreen - conceived and executed with the connivance or involvement of the assessee excludes the applicability of the ratio. In our understanding, the ratio is attracted to a case where it is a simple question of whether the assessee has discharged the burden placed upon him under sec.68 to prove and establish the identity and creditworthiness of the share applicant and the genuineness of the transaction. In such a case, the Assessing Officer cannot sit back with folded hands till the assessee exhausts all the evidence or material in his possession and then come forward to merely reject the same, without carrying out any verification or enquiry into the material placed before him. The case before us does not fall under this category and it would be a travesty of truth and justice to express a view to the contrary".

ii. **Hindusthan Tea Trading Co. Ltd. vs CIT 263 ITR 289 (Kol)**

"In Stellar Investment Ltd.'s case [2001] 251 ITR 263, the apex court had passed the following order: "We have read the question which the High Court answered against the Revenue. We are in agreement with the High Court. Plainly, the Tribunal came to a conclusion on facts and no interference is called for. The appeal is dismissed. No order as to costs." From the above observation, it appears that the Supreme Court has not

entered into the question involved or has not decided the ratio laid down. It had plainly held that it was a question of fact. The Supreme Court has not laid down any proposition with regard to the question. It was purely a question of fact with which the apex court had dealt with and was in agreement with the High Court on conclusion of facts. Therefore, it cannot be said that the Supreme Court answered the ratio laid down as sought to be propounded by the Delhi High Court in *Stellar Investment Ltd.*'s case [1991] 192 ITR 287. A decision becomes binding as a precedent only when the court decides a particular question of law or lays down the ratio through conscious adjudication.....

The above decisions almost in one voice laid down that when such question arises, it is incumbent on the assessee to prove and establish the identity of the subscriber and prove their creditworthiness and the genuineness of the transaction. The furnishing of material is not sufficient. The income-tax authority has a right to pierce the veil and find out the real nature of the transaction. But once sufficient material is produced and explanation is given, the onus is discharged and shifted on the Revenue. Having regard to the materials, it might ask for further materials from the assessee or it might come to a conclusion on the materials so produced as it might in law arrive at. Once the materials are there, it is incumbent on the assessing authority to enquire into the same. It cannot overlook one or the other materials nor can it undertake a half-hearted enquiry".

iii. **CIT v. Nipun Builders and Developers P. Ltd. [2013] 350 ITR 407 (Delhi)**

"the assessee cannot simply furnish details and remain quiet even when summons issued to shareholders under section 131 return unserved and uncomplied. This approach would be unreasonable as a general proposition as 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. Some cases might require or justify visit by the Inspector to ascertain whether the shareholders/subscribers were functioning or available at the addresses, but it would be incorrect to state that the Assessing Officer should get the addresses from the Registrar of Companies' website or search for the addresses of shareholders and communicate with them. Similarly, creditworthiness was not proved by mere issue of a cheque or by furnishing a copy of statement of bank account. Circumstances might require that there should be some evidence of positive nature to show that the said subscribers had made a genuine investment, acted as angel investors, after due diligence or for personal reasons. Thus, finding or a conclusion must be practicable, pragmatic and might in a given case take into account that the assessee might find it difficult to unimpeachably establish the creditworthiness of the shareholders."

iv. **In CIT v. N. R. Portfolio Pvt. Ltd. [2014] 2 ITR-OL 68 (Delhi); [2014] 206 DLT 97 (DB)**

"Mere production of incorporation details, PANs or the fact that third persons or company had filed Income-tax details in case of a private limited company may not be sufficient when surrounding and attending facts predicate a cover up. These facts indicate and reflect proper paper work or documentation but genuineness, creditworthiness, identity are deeper and obtrusive. Companies no doubt are artificial or juristic persons but they are soulless and are dependent upon the individuals behind them who run and manage the said companies. It is the persons behind the company who take the decisions, controls and manage them."

v. **CIT v. Gold Leaf Capital Corporation Ltd. [2013] 353 ITR 163 (Delhi)**

The Hon'ble Court concurred with the view of the Hon'ble Tribunal and observed that:

"The conduct of the assessee has been beautifully summarized by the Tribunal itself in the following manner:

"All this is again indicative of the fact that in fact the assessee from day one of initiation of initial assessment proceedings was in a position to exercise control on the investing companies and still it withheld all the necessary information called for by the Assessing Officer, which could enable the Assessing Officer to test the genuineness of the transaction and creditworthiness of the investing companies by verifying the genuineness of the claims made by the assessee before the CIT (A) on the basis of those documents which the assessee filed for the first time before the CIT (A) during the 2nd inning or the appellate proceedings.

Thus, it stands established that in fact the assessee produced only the information/documents/person for recording statement called for by the Assessing Officer which suited the interest of the assessee and intentionally withheld that information which did not suit the interest of the assessee."

vi. **CIT vs Navodaya Castles (P.) Ltd. [2014] 367 ITR 306 (Delhi)**

"13. As we perceive, there are two sets of judgments and cases, but these judgments and cases proceed on their own facts. In one set of cases, the assessee produced necessary documents/evidence to show and establish identity of the shareholders, bank account from which payment was made, the fact that payments were received thorough banking channels, filed necessary affidavits of the shareholders or confirmations of the directors of the shareholder companies, but thereafter no further inquiries were conducted. The second set of cases are those where there was evidence and material to show that the shareholder company was only a paper company having no source of income, but had made substantial and huge investments in the form of share application money. The assessing officer has referred to the bank statement, financial position of the recipient and beneficiary assessee and surrounding circumstances. The primary requirements, which should be satisfied in such cases is,

identification of the creditors/shareholder, creditworthiness of creditors/shareholder and genuineness of the transaction. These three requirements have to be tested not superficially but in depth having regard to the human probabilities and normal course of human conduct.

14. Certificate of incorporation, PAN etc. are relevant for purchase of identification, but have their limitation when there is evidence and material to show that the subscriber was a paper company and not a genuine investor. It is in this context, the Supreme Court in *CIT v. Durga Prasad More* [1971] 82 ITR 540 (SC) had observed:—
....."

The Hon'ble Supreme Court rejected the SLP filed in the above case **Navodaya Castle (P.) Ltd. Vs CIT** [2015] 56 taxmann.com 18 (SC) with the observation:

"We do not see any merit in this special leave petition, which is hereby dismissed".

vii. **Onassis Axles P. Ltd. v. CIT** [2014] 364 ITR 53 (Delhi)

"14. Lovely Exports Pvt. Ltd. (supra) is an authority for the proposition that the assessee is under an obligation to dispel any doubts regarding the genuineness of an investor and the genuineness of the transaction. Here, though the assessee furnished particulars relating to three share applicants, the further inquiry made by the Assessing Officer raised more questions than answers. The share applicants' lack of resources, the assessee's position vis-À-vis share amounts received and its commercial condition all pointed to the amount received by it falling within the mischief of section 68 as unexplained amounts. That the Assessing Officer or the Income-tax Appellate Tribunal chose to treat the amount, as bogus share capital, is a matter of inference which the court would be loath to interfere with.

15. For the above reasons, this court answers the question framed, in favour of the Revenue and affirms the view of the Income-tax Appellate Tribunal. The appeal is, therefore, dismissed, with no order as to costs."

viii. **Commissioner of Income Tax-II vs. Jan Sampark Advertisement & Marketing Pvt. Ltd.** 2015-TIOL-600-HC-DEL-IT.

"Since section 68 itself declares that the credited sum would have to be included in the income of the assessee in the absence of explanation, or in the event of explanation being not satisfactory, it naturally follows that the material submitted by the assessee with his explanation must itself be wholesome or not untrue. It is only when the explanation and the material offered by the assessee at this stage passes this muster that the initial onus placed on him would shift leaving it to the AO to start inquiring into the affairs of the third part."

7. **Summary of legal principles as laid by Hon'ble Delhi High Court in above referred to cases for analysis of explanation of the assessee:**

It is evident from foregoing legal analysis that following parameters have been laid down in the decisions cited supra:

- Mere production of incorporation details, PAN or the fact that third persons or company had filed Income Tax details may not be sufficient when surrounding and attending facts predicate a cover up.
- Paper work like details of PAN, Income Tax Return, details of cheque and bank accounts indicate and reflect proper paper work or documentation but genuineness, creditworthiness and identity are deeper and obtrusive.
- Companies no doubt are artificial or juristic persons but they are soulless and are dependent upon individuals behind them who take the decision manage control the said companies.
- It would be incorrect to state that the AO should get the addresses from Registrar of the Companies website or search for the addresses of shareholders and communicate with them.
- Creditworthiness was not proved by mere issue of a cheque or by furnishing a copy of statement of bank accounts. Circumstances might require that there should be some evidence of positive nature to show cause that the said subscribers had made a genuine investment, acted as angle investors, after due diligence or for personal reasons.
- Where there is admission before the investigation wing of the department that the subscribers to share capital had availed accommodation from bogus entry operators creditworthiness must be proved and these factual aspects and circumstances as proved before investigation wing cannot be simple to ignore.
- Source of funding is important ingredient of the onus of the assessee.
- It is not sufficient that the identity of the share application or creditors should be established for the assessee to discharge the initial onus which is upon the assessee. Under the requirement of section 68, the assessee has to further satisfy the Revenue as to the genuineness of the transaction and creditworthiness of the share applicant or the individual who is advancing amounts.

The AO may consider the above referred legal jurisprudence while examining issue of genuineness of share capital/share premium received by the company u/s.68 of the Act.