



## Share premium amount added to the income of the taxpayer due to failure to prove identity, genuineness and creditworthiness of the investors

### Background

Recently, the Ahmedabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Umiya Pipes Pvt. Ltd<sup>1</sup> (the taxpayer) confirmed the addition on account of share premium under Section 68 of the Income-tax Act, 1961 (the Act) since the taxpayer failed to discharge its onus in proving identity, genuineness, and creditworthiness of the applicants paying share premium to the taxpayer. The Tribunal observed that such an onus does not get discharged by the mere filing of confirmation letter or by receiving the amount through banking channel or by filing Permanent Account Number (PAN) particulars. The majority of the information filed by the taxpayer were either incomplete or incorrect, and there is no proper explanation provided by the taxpayer which is justifiable. The onus is on the taxpayer to prove the genuineness of the share premium.

### Facts of the case

- This taxpayer is a private limited company manufacturing PVC pipes. During the Assessment Year (AY) 2002-03, the taxpayer has issued shares of face value of INR 10 each at a premium of INR90 per share and credited the same in the books of accounts. The taxpayer filed a return of income declaring a loss.
- The Assessing Officer (AO) noticed that net profit of the taxpayer has come down from 4.94 per cent to 2.35 per cent in the two assessment years. Therefore, the AO initiated assessment proceedings under the Income-tax Act, 1961 (the Act) and has issued scrutiny notices seeking reasons thereof. The AO asked the detailed reason for loss reported during the year and requested detailed information with respect to share premium received during the year.
- Since the taxpayer failed to produce books of accounts, the AO adopted net profit rate of 4.94 per cent by completing the best judgment assessment under Section 144 of the Act. The AO added the share premium payment under Section 68 of the Act.
- On appeal before the Commissioner of Income-tax (Appeals) [CIT(A)], the taxpayer provided detailed names of its share premium parties with dates and PAN particulars and photocopies of confirmation in some cases. However, the CIT(A) rejected the said additional evidence of the taxpayer since the balance sheet produced by the taxpayer shows contrary figures, and it did not match with the details provided and lacks some information. The CIT(A) confirmed the addition made by the taxpayer.
- On appeal before the Tribunal, the taxpayer claimed that books of account could not be produced for verification, as the premises were sealed by banks. As the premises were de-sealed, the taxpayer pleaded again the opportunity of being heard. Therefore, the Tribunal referred the issue to the lower authorities for reconsideration after giving the opportunity of being heard.
- Consequently, the AO issued notices seeking details of share premium. However, the taxpayer replied that since City Civil Court had sealed the premises, it could not produce books of accounts. Subsequently, the AO retained its earlier addition in the second round of assessment proceedings. Similarly, the CIT(A) upheld the order of the AO.

<sup>1</sup> Umiya Pipes Pvt. Ltd v. ACIT (ITA No. 1679/Ahd/2014) – Taxsutra.com

- The taxpayer filed an appeal before the Tribunal.

### Tribunal's decision

- The explanation provided by the taxpayer does not support its case. The taxpayer did not undertake even a single step to prove identity, capacity and genuineness/creditworthiness of its 13 share premium paying applicants.
- This is not the taxpayer's case of having not being afforded an adequate opportunity of hearing in the consequential proceedings. The same factual position continued in the subsequent proceedings as well wherein it has filed the only photocopy of the confirmations in some of the cases.
- All the 13 parties seem to be based in Ahmedabad. Still, the taxpayer could not produce even one of the 13 parties. All the photocopy confirmations, i.e. well before this Tribunal's remand direction. All this reflects taxpayer's lack of explanation despite getting its matter remanded back to the AO.
- The taxpayer's act and conduct in not being able to file even a single original confirmation and its subsequent action in submitting all four photocopies of the same date indicate genuineness issue.
- The evidence provided by the taxpayer is not sufficient to delete the addition made by the lower authorities. On reference to the Calcutta High Court decisions<sup>2</sup> it indicates that such an onus does not get discharged by the mere filing of confirmation letter or by receiving the amount in question through banking channel or by filing PAN particulars.
- The decisions<sup>3</sup> relied on by the taxpayer are distinguishable of facts of the present case. The Supreme Court decisions<sup>4</sup> propounding genuineness theory on the touchstone of human probability are applicable to the facts of the present case as the taxpayer's entire evidence has not been able to satisfy any of the stated four benchmarks.
- The taxpayer has not been able to demonstrate the intrinsic value of shares to be at par with the share premium charged. It has not shown the crucial nexus between the premium vis-a-vis its in-built potential being the subscribing company justifying the exorbitant premium claimed to have been received in its own right. There can be no straight jacket formula for determining share premium which depends upon the current strength and future potential of an enterprise.

- The taxpayer's act and conduct having received such a high share premium purportedly towards share capital and premium in showing continuing inability to furnish the requisite information citing subsequent financial difficulties leading to its premises being seized therefore does not inspire confidence. Accordingly, it has been held that the taxpayer has miserably failed in proving the genuineness of its share premium.
- There is no material on record revealing the taxpayer to have proved the genuineness of the share premium even in preceding assessment year. Therefore, without any other substantive evidence proving genuineness does not inspire acceptance on mere technical reasons.

### Our comments

The Mumbai Tribunal in the case of Gagandeep Infrastructure Pvt. Ltd. held that the taxpayer had established the identity, genuineness, and capacity of the shareholders who had subscribed to its shares. The identity was established by detailed names, addresses of the shareholders, PAN, bank details and confirmatory letters were filed. The genuineness of the transaction was established by filing a copy of share application form, the form filed with the Registrar of Companies and as also bank details of the shareholders and their confirmations, which would indicate both the genuineness as also the capacity of the shareholders to subscribe to the shares. Therefore, an addition made by the AO under Section 68 was to be deleted. The Bombay High Court in the case of Gagandeep Infrastructure Pvt. Ltd.<sup>5</sup> upheld the Tribunal's decision.

However, the Tribunal in the present case has confirmed the addition on account of share premium under Section 68 of the Act since the taxpayer failed to discharge its onus in proving identity, genuineness, and creditworthiness of the share premium paying applicants.

It is important to note that GAAR provisions will come into effect from 1 April 2018 (Financial Year 2017-18). Under the GAAR provisions, the AO may treat transactions as 'impermissible avoidance arrangement' if the main purpose of the arrangement is to obtain tax benefit, and such arrangement is not at arm's length or results directly or indirectly, in the misuse, or abuse of the provisions of the Act or lacks commercial substance or it is not for bona fide purposes. As a consequence, the AO may, inter alia, disregard, combine or re-characterise whole or part of the arrangement, etc.

It would be important for the taxpayer to consider the provisions of GAAR before entering into similar transactions.

<sup>2</sup> CIT v. United Commercial & Industrial Co. Pvt. Ltd [1991] 187 ITR 596 (Cal) and CIT v. Precision Finance Pvt Ltd [1994] 208 ITR 465 (Cal)

<sup>3</sup> CIT v. Pragati Cooperative Bank Ltd [2005] 278 ITR 178 (Guj), Murlidhar Lahorimal v. CIT [2006] 280 ITR 512 (Guj)

<sup>4</sup> Sumati Dayal v. CIT [1995] 214 ITR 801 (SC), CIT v. Durgaprasad More [1971] 82 ITR 540 (SC)

<sup>5</sup> CIT v. Gagandeep Infrastructure Pvt. Ltd. (ITA No.1613 of 2014, dated 20 March 2017) – itatonline.com

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