

# TAX FLASH NEWS

8 March 2019

## Amount raised by way of issue of shares at a premium is chargeable to tax as per the provisions of Section 68 of the Income-tax Act – Supreme Court

Recently, the Supreme Court of India in the case of NRA Iron & Steel Pvt Ltd<sup>1</sup> (the taxpayer) dealt with the issue whether the amount raised by the taxpayer from various companies by way of issue of shares at a premium is chargeable to tax as per the provisions of Section 68 of the Income-tax Act, 1961 (the Act).

During the Financial Year 2008-09, the taxpayer received INR176 million from various companies against the issue of shares at a premium. The shares had a face value of INR10 per share which was subscribed by the investor companies at INR190 per share. The Assessing Officer (AO) requested the taxpayer to furnish details of the amounts received, and provide evidence to establish the identity of the investor companies and their credit-worthiness and genuineness of the transaction.

The taxpayer stated that it had received entire share capital through normal banking channels by account payee cheques/demand drafts, and produced documents such as income tax return acknowledgments to establish the identity and genuineness of the transaction. Hence, it was stated that the initial onus for establishing the credibility and identity of the shareholders was discharged under the provisions of Section 68 of the Act.

The AO held that the taxpayer failed to prove the existence of the identity of the investor companies and genuineness of the transaction. Further, some of the companies were found to be non-existent at the address furnished by the taxpayer. None of the companies produced the bank statements to establish the source of funds for making such a huge investment in the shares, even though they were

declaring negligible income in their tax returns. The AO held that the taxpayer had failed to discharge the onus by cogent evidence either of the credit-worthiness of the investor-companies, or genuineness of the transaction. Accordingly, the amount of INR176 million was to be added back to the total income of the taxpayer.

The Commissioner of Income-tax (Appeals) [CIT(A)] held that the taxpayer had filed confirmations from the investor companies, their tax returns, acknowledgments with PAN numbers, copies of their bank account to show that the entire amount had been paid through normal banking channels, and hence it discharged the initial onus under Section 68 of the Act, for establishing the credibility and identity of the shareholders. Accordingly, the CIT(A) held the decision in favour of the taxpayer. Subsequently, the Tribunal and the High Court also held the decision in favour of the taxpayer confirming the order of the CIT(A).

Aggrieved, the tax department filed an appeal before the Supreme Court. The issue before the Supreme Court was whether the taxpayer had discharged the primary onus to establish the genuineness of the transaction as required under Section 68 of the Act.

### Supreme Court decision

The Supreme Court referred to the decision of the Delhi High Court in the case of Oasis Hotel Pvt. Ltd.<sup>2</sup> and observed that merely proving the identity of the investors does not discharge the onus of the taxpayer if the capacity or credit-worthiness has not been established.

<sup>1</sup> Pr.CIT v. NRA Iron & Steel Pvt Ltd [Civil Appeal arising out of SLP (Civil) No. 29855 of 2018] – Taxsutra.com

<sup>2</sup> CIT v. Oasis Hotel Pvt. Ltd. [2011] 333 ITR 119 (Del)

In the present case, the AO made an independent and detailed enquiry, including a survey of the various investor companies to verify the credit-worthiness of the parties, the source of funds invested, and the genuineness of the transactions. However, the AO revealed that the shareholders were either non-existent, or lacked creditworthiness.

The Supreme Court referred the decision of the Guwahati High Court in the case of Nemi Chand Kothari<sup>3</sup> where it has been held that merely because a transaction takes place by cheque is not sufficient to discharge the burden. The taxpayer has to prove the identity of the creditors and genuineness of the transaction. The credit-worthiness or genuineness of a transaction regarding share application money depends on whether the two parties are related or known to each other, or mode by which parties approached each other, whether the transaction is entered into through written documentation to protect investment, whether the investor was an angel investor, the quantum of money invested, credit-worthiness of the recipient, object and purpose for which payment/investment was made, etc. The incorporation of a company, and payment by banking channel, etc. cannot in all cases tantamount to the satisfactory discharge of onus. The Supreme Court also referred to the decision of N.R. Portfolio (P.) Ltd<sup>4</sup>.

It was observed that the taxpayer is under a legal obligation to prove the genuineness of the transaction, the identity of the creditors, and credit-worthiness of the investors who should have the financial capacity to make the investment in question, to the satisfaction of the AO, so as to discharge the primary onus. Reference was made to the decision of the Calcutta High Court<sup>5</sup> and the Supreme Court cases<sup>6</sup>. The AO is duty bound to investigate the credit-worthiness of the creditor/subscriber, verify the identity of the subscribers, and ascertain whether the transaction is genuine, or these are bogus entries of name-lenders. If the enquiries and investigations reveal that the identity of the creditors to be dubious or doubtful, or lack credit-worthiness, then the genuineness of the transaction would not be established. In such a case, the taxpayer would not have discharged the primary onus contemplated by Section 68 of the Act.

In the present case, the taxpayer had not proved that the share application money was received from independent legal entities. The survey conducted by the AO revealed that some of the investor companies were non-existent, and had no office at the address

mentioned by the taxpayer. Therefore, the genuineness of the transaction was found to be completely doubtful. The investor companies had filed tax returns for a negligible taxable income, which would indicate that the investors did not have the financial capacity to invest funds for the purchase of shares at such a high premium.

The reason for the investment made by the investor companies in the taxpayer at a high premium of INR190 per share has not been given. Further, none of the investor companies established the source of funds from which the high share premium was invested. The mere mention of the income tax file number of an investor was not sufficient to discharge the onus under Section 68 of the Act. The entire transaction was bogus and lacked credibility.

The practice of conversion of unaccounted money through the cloak of share capital or premium must be subjected to careful scrutiny. This would be particularly so in the case of private placement of shares, where a higher onus is required to be placed on the taxpayer since the information is within the personal knowledge of the taxpayer. The taxpayer is under a legal obligation to prove the receipt of share capital/premium to the satisfaction of the AO, failure of which, would justify the addition of the said amount to the income of the taxpayer.

Since the taxpayer failed to discharge the onus required under Section 68 of the Act, the AO was justified in adding back the amounts to the taxpayer's income.

## Our comments

In various cases<sup>7</sup> the Courts have held that receipt of share premium cannot be assessed as unexplained credit where the transaction, identity of the payer and capacity of the subscriber are genuine. However<sup>8</sup>, the share premium can be assessed as undisclosed income in the absence of genuineness.

In various cases<sup>9</sup> it was held that without filing a confirmation letter from the creditor, the genuineness of the cash credit cannot be said to have been proved by the taxpayer. The taxpayer has to establish three things necessary to obviate the mischief of Section 68 of the Act i.e. identity of the investors, their creditworthiness/investments, and

<sup>3</sup> Nemi Chand Kothari v. CIT [2003] 264 ITR 254 (Gau)

<sup>4</sup> CIT v. N.R. Portfolio (P.) Ltd [2014] 222 Taxman 157 (Del)

<sup>5</sup> CIT v. Precision Finance Pvt. Ltd. [1994] 208 ITR 465 (Cal)

<sup>6</sup> Mohammad Hanif v. CIT [1963] 50 ITR 1 (SC), Roshan Di Hatti v. CIT [1977] 107 ITR (SC)

<sup>7</sup> CIT v. Green Infra Limited (ITA No. 1162 of 2014, dated 16 January 2017) (Bom), V. R. Global Energy Pvt. Ltd v. ITO (Tax Case (Appeal) No.246 of 2017, 6 August 2018) (Mad), DCIT v. Piramal Realty (P.) Ltd [2019] 174 ITD 633 (Mum), ACIT v. Ravnet Solutions (P.) Ltd [2018] 93 taxmann.com 59 (Del)

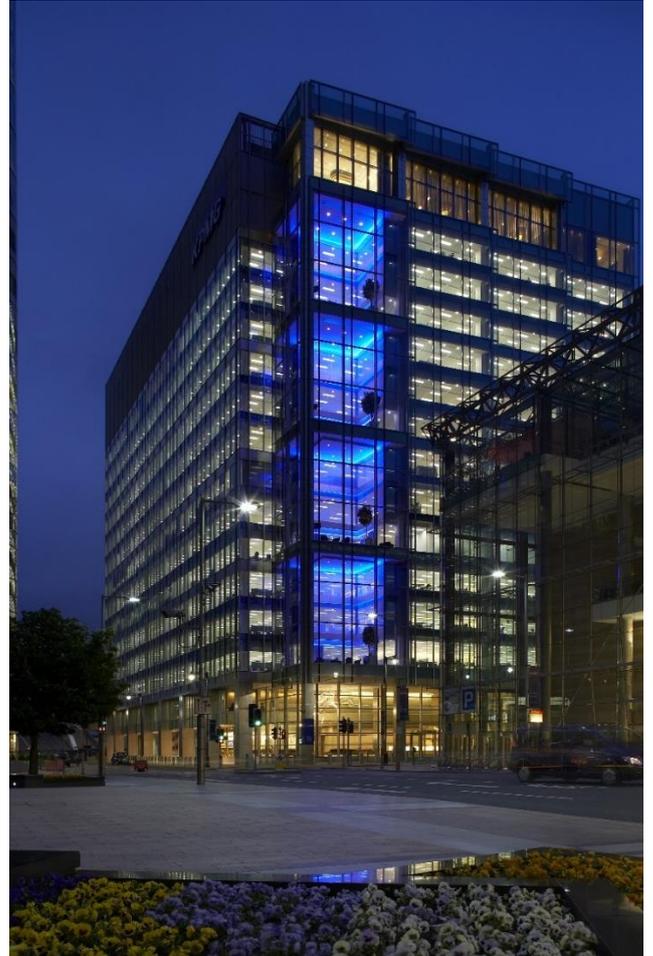
<sup>8</sup> Cornerstone Property Investments Pvt. Ltd v. ITO (I.T. A. No. 665/Bang/2017, dated 9 February 2018), Bisakha Sales (P.) Ltd. v. CIT [2014] 52 taxmann.com 305 (Kol), Sun Direct TV Pvt. Ltd v. ACIT [2018] 259 Taxman 228 (Mad)

<sup>9</sup> CIT v. Korlay Trading Co. Ltd. [1998] 232 ITR 820 (Cal.), CIT v. Oasis Hospitalities Pvt. Ltd. [2011] 333 ITR 119 (Delhi), Kale Khan Mohammad Hanif v CIT [1963] 50 ITR 1 (SC), Roshan Di Hatti v CIT [1977] 107 ITR 938 (SC)

genuineness of the transaction. However, the Delhi High Court in the case *Divine Leasing*<sup>10</sup> held that the AO had not brought any positive material or evidence which would indicate that the shareholders were (a) benamidars or (b) fictitious persons or (c) any part of the share capital represented the company's own income from undisclosed sources. Since the AO had failed to react to the shifting of the burden to investigate the creditworthiness of the share applicants, the appeal was dismissed.

The Supreme Court in the present case observed that the genuineness of the transaction was found to be completely doubtful. The investor companies had filed tax returns for a negligible taxable income, which would indicate that the investors did not have the financial capacity to invest funds for the purchase of shares at such a high premium. Accordingly, the Supreme Court held that since the taxpayer failed to discharge the onus required under Section 68 of the Act, the AO was justified in adding back the amounts to the taxpayer's income.

The Finance Act, 2012 amended the provisions of Section 68 of the Act with effect from assessment year 2013-14. The amended provisions specifically deal with the share application money, share capital and share premium and *inter alia* provide that the taxpayer's explanation shall be deemed to be unsatisfactory unless the person in whose name the share application money/premium is credited also offers a satisfactory explanation.



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<sup>10</sup> CIT v. Divine Leasing & Finance Ltd [2008] 299 ITR 268 (Del)

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