Issues in Cash Credits U/S 68

by

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Date: 28.12.2018

What we dwell…

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Brief of Sec 68

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- Where any sum is found credited in the 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 AO satisfactory, the sum so credited may be charged to income-tax as income of the assessee of that previous year.
- where a company, in which public are not substantially interested, receives any sum, whether share application money or share premium or whatever name called, from a resident(except VCF/VCC) ***both the company and payer of the sum should explain the source of amount***.(Summarised)

Important Questions

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Whether any sum referred to in Sec 68 is income as per Sec 2(24)?

- Sec 2(24) has defined the term Income in an inclusive manner. Sec 14 of the Income Tax Act for the purpose of charge of tax and computation of total income all income shall be classified as Salaries etc. The Sec 14 starts with save as otherwise provided in the Act provides for scope for deemed income referred to in Sec 68. So it is not an income in the normal sense.

Is chargeability of tax on the sum referred to in Sec 68 is charge as per the provisions of Sec 4 of the Income Tax Act, 1961?

- Tax payable U/S 68 was not on satisfaction on any liability U/S 4 of the Income Tax Act, 1961. It is a satisfaction of a new liability of tax in respect of income concealed by the assessee. It is a new charge to tax on ad hoc basis on disclosed income irrespective of the assessment year in which it was earned.

Whether sum charged U/S 68 is net of expenditure or subject to set off losses? In case not, why?

- When the Income is not classified under any heads of income U/S 14 it follows that question of giving any deduction of giving any deduction under provisions which correspond to such heads of income will not arise.

Rate of Tax and Penalties

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Amount is taxable at a flat rate without allowing any deductions and without basic exemption limit.

Scenario	Reflected in ITR	Determined by AO
Tax Rate	60%	
Surcharge	25%	25%
Penalty	NIL	10%[3]
EC and HC	4%[4]	4%

3. Voluntary Compliance during Search- 30%. Else- 60%
4. AY 19-20

Relevance with other sections-1/2

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Applicability of Sec 68 vs Sec 56(2)(viib)

Sec 68	Sec 56(2)(viib)
Any sum received by a Closely Held Company from a resident, the company and payer has to explain the source of such sum to the satisfaction of AO.	Any Consideration received by the Closely Held Company from resident in excess of FMV of share shall be explained
No valuation involved	FMV should be determined using the methods mentioned in Rule 11U/11UA
Share Application money is also covered	Only the consideration in excess of FMV is only covered
Income shall be taxed @30%	It is taxable under the head Income from other sources.

Where amount received for Shares in excess of FMV - Two issues – First Source of Consideration U/S 68 and Reason for excess amount U/S 56(2)(viib)

Relevance with other sections-2/2

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Applicability of Sec 68 vs Sec 56(2)(X):-

Sec 68	Sec 56(2)(X)
Any sum credited in the books of accounts of the assessee for which he offers no explanation or explanation is not satisfactory to the AO.	Any Person receives money/movable property/ Immovable Property without consideration or for in adequate consideration
No basic limit provided	Amount up to Rs. 50,000/- is not taxable.
No exemption in respect of amount received from relatives etc	Transactions with relatives are excluded
Income shall be taxed @30%	It is taxable under the head Income from other sources.

Even in case of Gift from Relatives the ability of the donor needs to be established

Penny Stock Issues

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- Penny Stocks are stocks of the company which has low market capitalisation and which trades at a very low price (say Rs. 10/- or less).
- Penny Stocks are often used to convert unaccounted money in to accounted money and without payment of tax by using provisions of Sec 10(38).
- Profits are booked by price manipulation. This will be achieved by circular trading.
- FA 2017 has provided that exemption U/S 10(38) is not available when the STT is not paid at the time of acquisition, subject to exceptions.
- FA 2018 has provided for taxation @10% U/S 112A in case of LTCG > Rs. 1 Lakh from listed equity shares or Units of EOF on which STT paid at the time of acquisition and sale subject to exceptions.

Peak Credit Theory-1/2

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- Though bank account is not part of books of the account maintained by the assessee, he has to explain the source of the credit when ever asked for.
- The general argument is earlier cash withdrawals are the source of subsequent cash deposits.
- Peak Credit Theory is applicable only for cash deposits and cash withdrawals.
- This theory has no place in Income-Tax Act, 1961. This theory is applied only to make sure that a person should not be taxed more than once for the same source of income.

Peak Credit Theory- 2/2

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Example:-

Date	Particulars	Deposit (Rs)	Withdrawal (Rs)	Balance (Rs)
April -1	OB			2500
April-10	Cash	28,000		30,500
April-20	Cash	35,000		65,500
June-10	Cash		20,000	45,500
June-20	Cash	25,000		70,500
July-10	Cash	50,000		1,20,500
Aug-8	Cash	60,000		1,80,500
Aug-30	Cash		50,000	1,30,500

Peak Credit is Rs. 1,80,500/-

Relevant Judgements

- Shares issued for settlement of liability are not subject to Sec 68- V.K. Global Energy (P) Ltd 96 Taxmann.com 647

- Assessee has to explain with cogent evidence to explain as to how shares in a unknown company had jumped in no time- Sanjay Bimalchand Jain 89 Taxmann.com 196

- When financial worth of company is meagre and there is an abnormal price rise it could be a case of introduction of unaccounted money in grab of LTCG- Smt. M.K. Rajeswari 99 Taxmann.com 339

- Transactions done through Demat A/C, payments made through bank with evidence of contract notes etc could not be taxed U/S 68- Smt. Madhu Killa 100 Taxmann.com 264

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Thank you!!!

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