

Chapter V: Fictitious sales and purchases by Shell Companies/Hawala Operators

This Chapter deals with the fictitious transactions which took place between Bogus Entry Providers and their beneficiaries which led to generation of unaccounted income. Audit noticed failure of the ITD to effectively use various tools at its disposal to carry out suo motu detailed investigation of the facts and take up cases for scrutiny in order to bring to book the severe economic offenders.

5.1 Fictitious transactions

The White paper on Black Money defines Black money “as assets or resources that have neither been reported to the public authorities at the time of their generation nor disclosed at any point of time during their possession”. Significant amount of black money is generated through legally permissible economic activities, which are not accounted for and disclosed or reported to the public authorities as per the law or regulations. The fundamental reason for the generation of black money is to evade payment of taxes by reducing profits.

One of the most common ways to reduce profits is by inflating the purchase/raw material cost, expenses like labour charges, entertainment expenses and commission. In such cases, bogus bills may be prepared to show inflated expenses in the books. It involves obtaining bogus or inflated invoices from the so called 'bill masters', who make bogus vouchers and charge nominal commission for this facility. Such a practice also involves the 'hawala' operators, who operate shell entities in the form of proprietorship firms, partnership firms, companies and trusts for accepting cheques for payments claimed as expense in exchange of cash after charging some commission and give rise to the black money in the market.

5.2 Role of Income Tax Department

The ITD is primarily responsible for combating the menace of black money. For this purpose, it uses the tools of scrutiny assessment as well as information-based investigations for detecting tax evasion and penalizing those found guilty of tax evasion as per provisions of the Income Tax Act, with the objective of creating deterrence against tax evasion. In doing so, ITD plays an important role in preventing generation, accumulation and consumption of unaccounted black money⁸⁶.

86 White paper on Black Money dated 16 May 2012

5.3 Audit findings

During financial year 2008-09, Maharashtra Sales Tax Department (MSTD) disclosed⁸⁷ before Bombay High Court that it had investigated about 1,555 hawala operators involving about 39,488 beneficiary dealers, who during the course of the previous three years had passed on an input tax credit of ₹ 1333 crore. The modus operandi was to claim and obtain input tax credit against the declaration of fake tax invoices without actual transactions involving the sale and purchase of goods. In order to show the transaction genuine, payments were made against the invoices by cheque or bank transfer and later on the amounts were reversed/withdrawn from the bank accounts of the hawala dealers.

The MSTD started putting the “**list of suspicious dealers who has issued false bills without delivery of goods**” on its website from 21 November 2011 onwards. At present the list contains around 2,059 dealers who had issued invoices involving tax evasion of more than ₹ 10,640 crore (including the maximum VAT at the rate of 12.5 per cent in Maharashtra).

In order to verify the efficacy of the ITD in using the tools of scrutiny assessment as well as information based investigation, we requested the Investigation wing of ITD as well as the Pr. CCIT Mumbai (November 2015) to share the data of assesseees whose names figured in the list put forth by MSTD as having issued bogus accommodation invoices⁸⁸ and the related beneficiaries. No such data was shared with Audit despite a reminder and a meeting with them (May 2016). Consequently, we undertook verification of the assessment records of the suspicious accommodation entry providers and the beneficiaries as disclosed by MSTD on their website. Findings of audit are discussed in subsequent paragraphs.

5.4 Bogus entry providers⁸⁹

We examined records pertaining to AYs 2009-10 to 2013-14 of 35 cases (*Appendix 5.1*) having PANs in the bogus purchases list of MSTD. Audit noticed that the assesseees either (i) did not file the return or (ii) filed returns with meager income or (iii) nil income or (iv) stopped filing return in later years. ITD took up the cases for scrutiny only those cases where income was reported. ITD did not take any action to examine the veracity of the facts reported therein nor did they fully follow the information provided by their own Investigation wing. Two cases are illustrated below:

87 M/s Timex Art Décor Pvt. Ltd. vs. the State of Maharashtra & Others. Judgement delivered by Bombay High Court on 25 March 2013.

88 Accommodation invoice is a bill of exchange endorsed by a reputable third party (called an accommodation party or accommodation endorser) acting as a guarantor, as a favour and without compensation, which can be discounted on the strength of the guarantor who remains liable until the bill is paid.

89 Companies/individuals who issue fictitious accommodation invoices

5.4.1 In CIT Central IV, Mumbai, **M/s Superfine Trading Co. Pvt. Ltd.** (PAN-AAJCS3337G) had shown sales/ gross receipts of business or profession aggregating ₹ 95.38 crore against accommodation invoices issued during the years relevant to AYs 2009-10 and 2010-11. In its computation of income, the assessee worked out returned income at ₹ 12.07 lakh and ₹ 10.05 lakh respectively for the two AYs, but did not pay any tax thereon. The ITD did not scrutinize the returns filed by the assessee despite the indication from the list put out by MSTD of a large number of the fake accommodation invoices issued by the firm that were indicative of generation black income.

The Ministry⁹⁰ accepted the observation (20 September 2016) stating that the cases for AY 2009-10 and 2010-11 were scrutinized under section 144/153C at incomes of ₹ 1.77 crore and ₹ 1.14 crore as against returned income of ₹ 12.07 lakh and ₹ 10.05 lakh respectively. Turnover was taken as per all credits in the bank accounts. The assessee did not attend the assessment proceedings; hence identification of beneficiaries of accommodation entries could not be made.

The Ministry's reply reflects the perfunctory approach of the ITD as the AO did not use the information available with the Investigation wing while checking the bank accounts nor made any attempt to establish the flow back of funds to the beneficiaries. The possibility of higher taxable income escaping assessment can not be ruled out against the assessed income.

5.4.2 In CIT Nasik, in the case of **M/s Ketna Engineers** (PAN-DASPS1751R) and **M/s Brij Corporation** (PAN-BBYP6024G), AO made additions of ₹ 1.06 crore and ₹ 7.43 crore respectively for AYs 2010-11 and 2011-12 in January 2015, based on the information received from DGIT (Investigation) Pune though the assessee did not file any return/detail. The department could not trace the whereabouts of the proprietors of these concerns despite service of statutory notices and hence the recovery of the demands raised was doubtful.

The Ministry stated (16 November 2016) that the department raised demand of ₹ 78.67 lakh and ₹ 5.80 crore respectively in two cases in AY 2011-12 under section 143(3)/147 after making, additions on account of bogus purchases/hawala transactions. Various efforts including department field enquiries, police enquiries at Nashik and Mumbai, and enquiries from Sub-Registrar-Nashik, have not yielded any information about the present whereabouts of the assesseees.

The Ministry has not given any reasons for the delay in taking action when the MSDT had put the details of the firms in public domain in 2012 itself. The

90 Ministry of Finance, Central Board of Direct taxes

scrutiny assessment for a solitary AY 2011-12 was completed in January 2015. The assessee being not traceable and the department having not been able to establish the money trail and the beneficiaries of bogus purchases, the inordinate delay on the part of ITD led to permanent loss of revenue.

5.5 Beneficiaries of bogus entry providers

We examined records pertaining to AYs 2009-10 to 2012-13 of another 13 cases appearing in the MSTD list who were beneficiaries of bogus entry providers and had received accommodation entries from Utkantha group which was also appearing in the MSTD list. Audit found that ITD did not properly scrutinize returns of their income, books of accounts and bank accounts and other transactions that should have been the main links in the chain of evasion of taxes by booking of bogus purchases. The cases are given below:

5.5.1 Disallowance not made by AO

ITD did not make any disallowance in the case of M/s Hiren Orgochem Ltd. (₹ 13.19 crore) and M/s Hitech Engineers (₹ 15.17 crore). In the case of M/s Birla Cotsyn, ITD reopened assessment under section 153A specifically for looking into bogus purchases but did not disallow bogus purchase of ₹ 27.68 crore. In case of M/s Elder Pharmaceuticals Ltd., ITD did not make any addition on the ground that the total accommodation purchases was ₹ 76.39 crore and sale was ₹ 77.40 crore.

The Ministry accepted the observation in all the four cases (20 September 2016 and 16 November 2016) stating as below:

- *In case of M/s Hiren Orgochem Ltd., 12.5 per cent of the alleged purchase was added to the income in AY 2009-10 in view of the ratio laid down in the case of CIT versus Simit P. Seth⁹¹.*
- *In case of M/s Hitech Engineers, there was no information of accommodation entries of ₹ 15.17 crore in AY 2009-10 as pointed out by audit. Information has been received for accommodation entries of ₹ 26.25 crores from four group companies of Utkantha Group (as against Audit's information of ₹ 15.16 crores from two companies of Utkantha Group) pertaining to AY 2010-11. Remedial action under section 147 for AY 2010-11 has been initiated by issuing notice under section 148 issued on 07 November 2016.*
- *In case of M/s Birla Cotsyn, assessment under section 153A was completed on 28 March 2016 for AY 2008-09 to 2013-14. Additions on account of bogus purchases of ₹ 81.91 core were made, but no*

91 356 ITR 451 (Gujarat High Court 2013)

addition could be made regarding bogus purchases from M/s Utkantha Group *in the absence of any information. Remedial action was being taken by the AO.*

- *In case of M/s Elder Pharmaceuticals Ltd., revised assessment order was passed on 29 December 2015 creating additional demand of ₹ 95.78 lakh.*

Audit however found that action on the part of the AO in four above cases was not in order as is evident from the below:

- (i) In case of M/s Hiren Orgochem Ltd., the assessee was a manufacturer of chemicals. In such cases the whole purpose of obtaining the accommodation entries was to reduce the taxable income and siphon the money from the company. The case law quoted for disallowing 12.50 *per cent* is applicable for the trading concerns and not to manufacturing concerns. The assessee in this case was still benefiting being able to reduce its income by ₹ 11.54 crores (i.e. 87.5 *per cent* of bogus purchases).
- (ii) In case of M/s Hitech Engineers, the assessee had shown bogus purchases of ₹ 9.95 crore in AY 2009-10 from M/s Realstone in which no action has been taken by the department as yet.
- (iii) In the case of M/s Birla Cotsyn, ITD should have used the assessment of the accommodation entry providers (The Utkantha Group in this case) as a tool to obtain details and use the said evidence to disallow the purchases made by the beneficiaries after adducing all evidence including the flow back of funds from the entry providers instead of merely making addition on the basis of the details submitted by the MSTD. The assessee thus succeeded in concealing the bogus purchase of ₹ 27.68 crores made from Utkantha group even after the search at its premises.
- (iv) In the case of M/s Elder Pharmaceuticals Ltd., ITD made a minuscule adjustment of mere 1.25 *per cent* of the fictitious purchases accepting assessee's contention that he had made corresponding fictitious sales of ₹ 77.40 crores. It meant that the assessee passed on the fictitious entry to other concerns helping them to evade tax of ₹ 23.22 crores. The ITD should have identified those assesseees who made bogus purchases of ₹ 77.40 crores from Elder Pharmaceuticals Ltd. and taken action to complete the loop of the transactions of the fictitious purchases till the ultimate beneficiary of the bogus purchases is

brought to tax. Further, as per regulations by FDA⁹², pharma companies are required to mention the batch number and the name of the actual manufacturer in their records. The AO should have verified these stock records with a view to collecting requisite evidence about the actual beneficiaries

5.5.2 Jurisdictional AOs of the final beneficiaries not informed about fictitious purchases

In case of the other major beneficiaries M/s Gebi Steel Corporation (₹ 61.77 crore), M/s Indian Drape Pvt. Ltd. (₹ 12.52 crore), M/s Aristone Trading Pvt. Ltd. (₹ 6.58 crore), M/s Bhavishya Electrical Lamination (₹ 13.20 crore) and M/s Mital Corpn. Ltd. (₹ 16.54 crore), the jurisdictional AOs of the final beneficiaries were not intimated about the fictitious purchases made by the assessee with a view to bringing them to tax appropriately.

The Ministry did not accept the observation (16 November 2016) in the case of M/s Mital Corpn. Ltd., stating that the records were supplied to the AO of M/s Mital Corpn. Ltd., which was assessed in Circle 1(1), Indore (now in Circle 3(1), Indore). From the information available in the statement of Sri Abhishek S. Morarka, Director of M/s Utkantha Trading Ltd., addition was made in the case of M/s Mital Corpn. Ltd., in AY 2010-11 on account of commission paid on bogus billing.

The reply was not tenable as the department did not intimate whether the assessee was the ultimate beneficiary of the bogus purchase or an intermediary. It is still not clear as to when the information was passed on to the AO of Mital Corpn. and when the addition was made. Quantum and sections of the Act under which the addition was made and whether the department had established the money trail which was crucial to know the ultimate beneficiary were also not provided by the Ministry.

5.5.3 Non production of record to audit for cross verification

ITD did not furnish the requisite records to audit for cross verification of the bogus purchases made by M/s Mandhana Industries Ltd. (₹ 18.10 crores), M/s Varshraj Exports (P) Ltd. (₹ 5.12 crores), M/s Lakshmi Velvete (I) Ltd. (₹ 1.49 crore) and M/s Nemani Steels (P) Ltd. (₹ 1.64 crore).

The Ministry did not accept the observation (20 September 2016) in the case of M/s Mandhana Industries Ltd. stating that the assessee moved application before Settlement Commission and Commission passed its order on 30 August 2014, which had been given effect for AY 2006-7 to 2013-14. Consequently

92 Food and Drug Administration

AO had no jurisdiction over the case as case records were not available at that time.

Audit is of the opinion that Ministry has not specified whether the bogus purchases pointed out in audit were declared in the course of the settlement under section 245H(2)⁹³ of the Act. In this case, it was imperative for the AO to verify whether the assessee had made truthful disclosure of the fictitious purchase. In case of false disclosure, ITD should have moved to Settlement Commission for withdrawal of immunity.

The Ministry has accepted the observation (20 September 2016) in the case of M/s Varshraj Exports (P) Ltd. stating as follows:

- *For AY 2009-10, files were furnished to audit and rectification order under section 154 was passed at the instance of audit.*
- *For AY 2010-11, files were not located in post restructuring ward 11(3)(4), order under section 143(3) was passed by pre-restructuring ward 8(3)(4).*
- *For AY 2011-12, no scrutiny was made, hence files could not be made available.*
- *For AY 2012-13, the cases records were provided to audit and were available with the AO.*

The AO's action in this case was not tenable on the grounds that the audit of the case records for AY 2009-10 was made in June 2012 whereas fresh evidence regarding assessee having obtained bogus accommodation entries from Utkantha group was found in July 2012. It was still not clear whether the ITD had taken remedial action to disallow the bogus purchase by reopening the assessment under section 147 or review under section 263. The department neither furnished the records to audit nor gave any categorical reply whether the bogus purchases of ₹ 5.12 crores made during the years relevant to AY 2009-10 and AY 2012-13 were disallowed.

5.6 Non-linking of fictitious transactions

ITD restricted its assessment to the assessment records of the concerned assessee only instead of cross linking/covering the whole chain of such fake transactions with forward and backward linkages so as to find out the ultimate beneficiaries and tracing the paper and money trail to establish the flow back of funds to the beneficiaries. Four illustrations are given below:

⁹³ Section 245H(2) provides that any immunity granted to the person can be withdrawn by the Settlement Commission, if such person in the course of settlement proceedings has concealed any particulars material to the settlement or had given false evidence and thereupon such person may be tried for the offence with respect to which immunity was granted and become liable for penalty.

5.6.1 M/s Loha Ispaat Ltd. (PAN-AAACL1583C) accounted for bogus purchases⁹⁴ and brought back the cash generated therefrom as investment in shares through bogus entry provider. In FY 2012-13, the AO received post search additional information that the assessee had accounted for bogus purchases of ₹ 2999.01 crore and sales of ₹ 3031.79 crore pertaining to AY 2006-07 to AY 2012-13 from M/s Utkantha Trading Pvt. Ltd. and other group of companies. ITD accepted contention of the assessee that the said purchases/sales were accommodation purchases for turnover purposes without investigating or cross-checking with the central excise records of the assessee.

The assessee admitted during the assessment process (FY 2013-14) that bogus sales were made to companies like M/s Aeroflex Industries Ltd. (₹ 141.62 crore), M/s Forward Export Trading (₹ 403.29 crore) and M/s Hemeara India (P) Ltd. (₹ 111.05 crore), which were not reported to the AO concerned. Verification of the assessment records of M/s Aeroflex Industries Ltd. for AY 2009-10 and AY 2010-11 showed that ITD did not take any action to disallow the bogus purchases.

The Ministry accepted the observation (20 September 2016) stating as under:

- *Considering the bogus purchases/sale with M/s Utkantha Trading Pvt. Ltd., the AO worked out the income of ₹ 107.60 crore from such accommodation entry. Further, AO also made addition of ₹ 202 crore on account of unaccounted money introduction in the books of the assessee for bogus share application money. Further, assessee was not even given the benefit of telescoping as the unaccounted income from accommodation turnover was added separately from the addition of such income in form of share application money since the assessee failed to provide one to one linkage between the two. Adverse finding of the audit thus was not acceptable as AO made additions appropriately in the respective assessment years.*
- *As regards the transactions with M/s Aeroflex Industries Ltd. and others, AO had duly considered the issue of bogus purchases/sales made by the assessee including bogus share premium and completed the assessment for AY 2013-14 in March 2016 making additions on account of:*
 - (i) *bogus/unexplained share premium money under section 68 of ₹ 48 crore.*

94 Vide Appraisal report for the block period 2006-07 to 2012-13

- (ii) bogus accommodation entries of ₹ 77.04 crores as commission income (@1.5 per cent of total accommodation entries of ₹ 5136.56 crore).*
 - (iii) depreciation on bogus purchase of fixed assets of ₹ 94.31 crore.*
 - (iv) making payment without account payee cheque for amounts exceeding twenty thousand rupees under section 40A(3) of ₹ 1.47 lakh, and*
 - (v) late payment of employee provident fund under section 36 of ₹ 5.06 lakh.*
- *Ministry further stated that there was no loss of revenue as each bogus purchase involved bogus sales also. They are generally issued in order to inflate the balance sheet and turnover figures so as to avail increased bank loan by showing higher net worth and inflated turnover. The AO while making assessment for AY 2013-14 added back the commission income earned by the assessee for this cyclic bogus transaction. As a matter of fact, the assessee had shown sales at lower rate and sold the actual goods in grey market at higher price and thus reduced this turnover and his net profit. There was no evidence on record to substantiate the claim that goods have been sold in grey market at higher value. As regards non communication of the bogus sales made to companies such as M/s Aeroflex Industries Ltd. to respective AOs, the respective jurisdictional AOs of M/s Aeroflex Industries Ltd., M/s Forward Export Trading and M/s Hemeara India (P) Ltd., have been informed and remedial measures taken up.*

The contention of the Ministry is not acceptable as the ITD should not have accepted the contention of the assessee that the bogus purchases were backed by corresponding bogus sales, without making a proper investigation. The assumption that the assessee had recorded bogus purchases and sales only to inflate the turnover and to obtain the bank loans should not have been ab-initio accepted by the AO. Further such claim was not substantiated with any evidence on record. The ITD merely relied on the statements made by the assessee. Cross check of the data on bogus sales said to have been made by the assessee would reveal that the beneficiaries who had obtained the entries, had used it to reduce their profit and the ITD did not take any action to disallow the purchases in the hands of the beneficiaries. Consequently the beneficiaries took undue benefit of accommodation entries.

Further, the disallowance of ₹ 107.60 crores was not on account of bogus purchase per se but the value of the difference of the quantity (26,147.96 MT) of the bogus purchases and the bogus sales which the assessee claimed to be the bogus unsold purchases as shown in the closing stock. The ITD had made addition of ₹ 11.47 crores on account of commission paid to brokers in cash for making arrangements for bogus purchases and did not make any addition against total bogus purchases of ₹ 2,999.01 crores made from Utkantha Group. The AO made addition of ₹ 202 crore of share premium without mapping the flow back of funds, said to be generated from the bogus purchases. In the case of Ganayaka Steels Pvt Ltd commented in the subsequent paragraph, the ITD simply accepted the contention of the assessee that both the purchases as well as the corresponding sales were bogus, without cross checking the veracity of this statement or making proper analysis of the bank account of the companies from whom the assessee obtained accommodation entries. The buyers of these bogus sales were established companies but the ITD did not notify the AO of the beneficiaries to disallow the bogus sales of ₹ 3031.79 crores during the period AY 2006-07 to 2012-13.

Moreover, if there was no evidence to prove that the ITD had crossed checked the sales claimed to be non genuine. Further, if the Gross Profit (GP) ratio for the genuine sales was 28.72 *per cent*, the minimum addition should have been the GP ratio of 28.72 *per cent* and not 1.5 *per cent* as added by the ITD. The ITD did not make any verification of the central excise records and stock record which ascertained the actual gap in the quantity of sales and purchases based on actual evidence of the statutory records required to be made under Central Excise Act, 1944. In the absence of any appropriate evidence or such verification of mismatch in the quantitative data of the stock account, conclusion drawn by the ITD was not proper. Besides, ITD did not verify the bank accounts to verify the flow of funds in regard to fictitious purchases and sales.

5.6.2 M/s Ganayaka Steels Ltd. (PAN-AADCG3686N) had two Directors for merely signing the papers of the company., The directors of M/s Loha Ispaat Ltd accepted during investigation (February 2012) that their group had effectively managed M/s Ganayaka Steels Ltd., which had shown sales of ₹ 111.75 crore to M/s Loha Ispaat Ltd. and others in AY 2010-11. Assessee's bank account disclosed that it had received ₹ 26.30 crore only from M/s Loha Ispaat Ltd. Difference of ₹ 76.29 crore receivable from Loha Ispaat and others was reduced from Sundry debtor without any receipt, indicating that it was either diverted or written off without receipt of money. Transfers of ₹ 9.38 crores (AY 10-11) and ₹ 13.41 crore (AY 12-13) were made to a

Director and family member of M/s Loha Ispaat Ltd. without assigning any reasons. This was indicative of a systematic diversion of money to the family members of Directors of M/s Loha Ispaat Ltd. ITD did not look into the above discrepancies and made additions of merely two *per cent* of the sales of ₹ 111.75 crore i.e. ₹ 2.24 crore (AY 10-11) and 2 *per cent* of ₹ 19.04 crore i.e. ₹ 38.07 lakh (AY 12-13).

5.6.3 M/s SKM Real Infra Ltd. (PAN-AAFCS2659R) was a group company of M/s Shree Ram Mills. During survey of M/s Shree Ram Mills group conducted in February 2013 it was found that the assessee company had taken accommodation invoices for purchases of value of ₹ 32.46 crore from hawala operators and made corresponding sale of ₹ 21.38 crore and balance of ₹ 11.06 crore was included in closing stock. ITD disallowed only five *per cent* of sales of ₹ 21.38 crore i.e. ₹ 1.07 crore (AY 2009-10) being accommodation entries. Cross check of one of the recipient M/s Krishna Trading Corporation of the bogus sales (₹ 3.00 crore) who did not file return of income, revealed that the department did not go after the ultimate beneficiaries of such bogus sales that passed through several business concerns.

5.6.4 M/s Gini & Jony Ltd. accepted that the purchase of ₹ 14.52 crore in AY 2012-13 was bogus without any movement of goods which was in turn passed on to its subsidiary **M/s G. J. Freedom Fashions Pvt. Ltd.** (PAN-AACCG5427E). The ITD made addition of ₹ 29.06 lakh only two *per cent* of the purchase amount to the returned income of M/s Gini & Jony Ltd. However, no disallowance was made in the subsidiary company, the ultimate beneficiary.

The Ministry accepted the observation (20 September 2016) stating that the issue of bogus sales of ₹ 14.52 crore was under verification, the assessment records were not readily available. After verification, remedial action shall be initiated.

5.7 Inconsistency in disallowing/making additions in cases involving Bogus entries/purchases

We analyzed 845 cases of beneficiaries who had obtained bogus invoices aggregating ₹ 1167.11 crore against which addition of ₹ 210.55 crore at an average of 18.04 *per cent* of the bogus purchases was made to the return income. In 344 cases, AOs did not record any section of Income Tax Act in support of the disallowance made. Section 37, 68 and 69 of the Income Tax Act were quoted in 231 cases, 44 cases and 170 respectively for making disallowances. AO made proportionate disallowance under section 68 and 69 though these sections provided for disallowance of entire amount if it was unexplained. AOs rejected the books of accounts under section 145(3) in

19 cases, making disallowance of 12.5 per cent in 17 cases and full disallowance in two cases. Percentage of disallowance varied from 2 to 30 per cent in 536 cases involving bogus purchase of ₹ 1021.02 crore (87.48 per cent by value). Full disallowance was made in 279 cases involving ₹ 124.61 crore. The method of disallowance involved ad-hoc percentage, gross profit margin or peak credit method without applying any logical pattern pertaining to a particular type of industry or nature of operation.

5.7.1 Audit examined the link of beneficiaries of M/s Utkantha Trading Pvt. Ltd and found as follows:

- Assessment of M/s Utkantha Trading Pvt. Ltd. for the AY 2009-10 was completed in December 2011. We noticed from the affidavit given to MSTD in January 2010 by Shri Abhishek S. Morarka, Director of M/s Utkantha Trading Pvt. Ltd. that the company along with other companies were giving accommodation invoices only without actual sales or purchases. The payment was received through the banks and after retaining the commission, the payments were made back to beneficiary. MSTD declared the company as a suspicious dealer. This was also pointed out to the ITD (July 2012). AO accepted the observation and made additions after reopening the assessment under section 263 (January 2014) as below:

AY	Sales	Purchases	Basis of disallowance	(₹ in crore)
				Addition made
2009-10	179.68	178.77	0.5 per cent of the purchases	0.89
2010-11	43.54	61.77	Peak credit method	0.66
2011-12	56.14	38.15	Peak credit method	0.24

Banks informed the AO in 2013 that the assessee had either closed the bank accounts or left a nil balance or a very meager balance in the account. Thus the department was not in a position to recover the demands.

- Similarly, ITD made additions in the other group companies of M/s Utkantha Group without applying any uniform pattern of action as below:

AY	Sales	Purchases	Basis of disallowance	(₹ in crore)
				Addition made
M/s Citybase Multitrade P. Ltd., (PAN-AADCC4376R) - ITO 4(1), Thane				
2010-11	405.03	Data not available	5 per cent of ₹ 405.03 crore	20.25
2011-12	122.56	122.44	1.25 per cent of ₹ 8.78 crore	0.11
2012-13	42.15	8.06	No disallowance	nil
M/s Candy Filters (Bombay) Ltd. (PAN-AAACC4124C) - ITO(1)(1)(2), Mumbai				
2009-10	113.06	112.85	0.25 per cent of ₹ 113.06 crore	0.28
2010-11	182.86	182.77	0.25 per cent of ₹ 56.80 cror	0.14

2011-12	5.81	8.31	Not assessed	nil
2012-13	6.5	6.47	No disallowance	nil
M/s Realstone Exports Ltd. (PAN-AACCR8504K) - ITO 11(1)(2), Mumbai				
2010-11	273.22	290.59	1 per cent of ₹ 279.76 crore	2.78
2011-12	59.85	85.55	1 per cent of ₹ 115.90 crore	1.16
2012-13	68.57	68.2	1 per cent of ₹ 30.07 crore	0.3
M/s Siddhpad Trading Pvt. Ltd. (PAN-AAMCS2192L) - ITO 1(3)(2), Mumbai				
No disallowance were made in any assessment years.				
M/s Duralloy Cutters P Ltd. (PAN-AABCD4127B) - ITO 6(2)(3), Mumbai				
Files were not furnished to audit.				

It is seen from the above that M/s Citybase Multitrade Pvt. Ltd. made purchases of ₹ 8.06 crore for AY 2012-13. Cross check of records of M/s Realstone Exports Pvt. Ltd. for AY 2012-13 revealed that total sales made to M/s Citybase Multitrade Pvt. Ltd. were ₹ 44.76 crore as against ₹ 8.06 crore. ITD did not make any attempt to reconcile the difference.

- Further, Utkantha Group created a chain of 23 companies (including six companies investigated by the MSTD) which were engaged in intricate circular trading, a very serious economic offence, without actual sales and purchases to help the beneficiaries evade the payment of income tax over ₹ 647 crore by booking fictitious expenses in their books. No action was taken to prosecute the Directors of the companies under the provisions of section 276 of the Act and their companies got away with meager addition. As per the records made available to audit, against the total amount of sales of ₹ 2,183.72 crore, the department made a disallowance of ₹ 26.94 crore only which worked to on average of 1.23 per cent.

The Ministry accepted the observation (20 September 2016) stating as below:

In the case of M/s Utkantha Trading Pvt. Ltd., the income of the assessee was estimated on the basis of the facts of each year. Audit has not pointed out any specific method on use of such method for estimating the income.

In the case of M/s Candy Filters (Bombay) Ltd., for AYs 2009-10 and 2010-11, additions of 0.25 per cent commission income were made based on report received from Investigation wing. Proposal for reopening the case for AY 2011-12 is being sent. No such circular/entry providing transactions was found in AY 2012-13 and the assessee had changed its trade.

In the case of M/s Realstone Exports Ltd., additions were made uniformly at the rate of one per cent on sales and purchases. Penalty had also been levied.

In the case of M/s Siddhpad Trading Pvt. Ltd., there was no information for bogus purchases in AY 2009-10. Proposal for reopening cases pertaining to AYs 2010-11 and 2011-12 has been sent.

As regards action taken by the ITD in four cases, audit is of the opinion as below:

In the case of M/s Utkantha Trading Pvt. Ltd., there was total lack of consistency in the additions made in regards to the disallowance made in same assessment charge from year to year even when the assessee was following same practice of giving accommodation entries. The speaking order did not specify as to why a specific method, peak credit method, was used in respective assessment years and how the percentage of disallowance was arrived at. For the use of peak credit method, clear evidence of rotation of funds was required whereas the ITD did not obtain even the bank accounts in this case to ascertain the flow of funds. The peak credit method was worked out on the basis of data supplied by the assessee, which was neither verified with the bank accounts nor cross-checked with the records of the beneficiaries.

In the case of M/s Candy Filters (Bombay) Ltd., in the same group company the ITD had made disallowance of five *per cent*. All the aspects having remained same, in this company the ITD made a addition of only 0.25 *per cent* in this case without elaborating as to how the disallowance of 0.25 *per cent* was arrived at and the methodology used to arrived at this percentage. For AY 2012-13, cross check of the records of M/s Gini & Jony Ltd. (as discussed in preceding para 5.6.4 of this report) revealed that the assessee had given accommodation entries involving ₹ 49.82 lakh. Hence the assessee had not made any circular/entry nor changed its trade in AY 2012-13. No person can sell goods without a valid registration⁹⁵. The assessee was continuing to give bogus entries even after the registration was cancelled. The ITD did not verify the complete loop of the transactions even when there was evidence to the contrary. Their conclusion that there was no circular/entry transaction in AY 2012-13, was not based on facts and not in order.

In the case of M/s Realstone Exports Ltd., the basis for working out disallowance at the rate of one *per cent* was also not mentioned in the speaking order. The ITD did not verify the bank accounts to ascertain the flow of funds. Further, the information on bogus sales was not passed on to the AOs of the beneficiaries for making disallowance defeating the very purpose of scrutiny of the entry providers.

In the case of M/s Siddhpada Trading Pvt. Ltd., the reply was factually incorrect and given without looking into the evidence, the affidavit given to MSTD in January 2010 by Shri Abhishek S. Morarka, Director of M/s Utkantha

95 Rule 9 of the MVAT

Trading Pvt. Ltd., which stated that the company along with other companies including M/s Siddhpad Trading (P) Ltd. were giving accommodation invoices without actual sales or purchases which established that the company was indulging in giving accommodation entries. Despite this clear evidence, the assessee had given accommodation entries of ₹ 176.18 crore in the AY 2009-10 to the beneficiaries enabling them to evade taxes by reducing their income but ITD did not take any action against the assessee. The assessment for AY 2009-10 became time barred resulting in loss of revenue. In the subsequent AYs 2010-11 and 2011-12, the ITD initiated action only at the instance of audit. No action has been initiated for the AY 2012-13 which involved accommodation entries of ₹ 48.63 crores.

5.7.2 MSTD declared **M/s Colourshop Trading (P) Ltd.** (PAN-ACCC6822H) as a hawala dealer. The Directors of this company Mr. Rajiv Rajendra Mody and Mr. Rajendrabhai Mody were Directors in five other companies also. The Assessment of the AY 2012-13 was completed under section 144 on 20 March 2015 by making addition of merely ₹ 1.33 crore i.e. 0.50 *per cent* of the sales ₹ 266.08 crore. The ITD did not initiate any action to identify whether the other associated companies were being assessed or not. We noticed that only one company of the group M/s Orbit Products Private Ltd. had filed its return for the AY 2010-11 onwards but scrutiny assessment of this company was not carried out to find out the recipients of the bogus invoices.

5.8 Inconsistent additions in case of other intermediaries and beneficiaries

We noticed that in cases pertaining to intermediaries and beneficiaries, the ITD lacked consistency in making additions and disallowances involving bogus purchases

5.8.1 **M/s Dev Steels** (PAN-AADFD9093M) had given accommodation bills of ₹ 108.61 crores given to M/s Unity Infra projects Ltd., for which AO made disallowance at two *per cent* (AY 2006-07 to 2010-11) as against five *per cent* recommended by investigation wing as the GP ratio of 1.54 shown by the assessee was very low.

The Ministry accepted the observation (20 September 2016) stating that order under section 263 has been passed for AYs 2006-07 to 2010-11 and assessments afresh will be completed by December 2016.

5.8.2 In the case of **Smt. Suman Vijay Gupta** (PAN-AHQPG0220P), the AO had disallowed ₹ 67.52 lakh i.e. only 25 *per cent* of the bogus purchases of ₹ 2.70 crore during AY 2010-11 (March 2013). However, in an identical case,

the AO disallowed the full amount of bogus purchases. ITD accepted the audit observation (January 2014).

The Ministry accepted the observation (20 September 2016) stating that action under section 153A for AY 2010-11 was under way and would be completed by 31.12.2016, disallowing total bogus purchases of ₹ 2.70 crores as pointed out in audit.

5.8.3 Shri Mohit Jain (PAN-AFAPJ6477R) as an intermediary had obtained purchase bills of ₹ 9.69 crore from hawala parties and then forwarded the same to Readymade Steel India Ltd. who passed it to the actual beneficiaries. The AO estimated the gross profit at three *per cent* of the sales (AY 2010-11) as against 12.50 *per cent* normally being adopted in case of trading concerns. The AO also did not report the matter to the AO of Readymade Steel so as to complete the loop of disallowance.

The Ministry did not accept the observation (16 November 2016) stating that the assessee was only a part of the link of entry providers of fictitious bills and not a self beneficiary of the bills arranged by him for M/s Readymade Steel India Ltd. The assessee had declared a GP of 1.56 per cent on the amount of bogus bills issued by him during the year. As such no further disallowance on this score, than the disallowance of three per cent as has been done by the AO in the assessment order, can be justifiably made. The Department, however, initiated remedial action in the light of the Board's Instruction, and disallowed the assessee's transactions with M/s Readymade Steel India Ltd. aggregating to ₹ 5.75 crore in their entirety.

The reply was not tenable for the following reasons:

- (i) Normally in trading concerns, department has been making additions of 12.5 *per cent* to 25 *per cent* whereas in this case the addition made was only 3 *per cent*. The objective of audit was to highlight the inconsistency of the department.
- (ii) The department having identified the assessee as a bogus entry provider ideally should have completed the loop by tracing the ultimate beneficiary of these bogus entry providers. However, the record furnished to audit did not reveal that any such efforts were made by the department.

5.8.4 M/s Siddivinayak Marketing (PAN-ABGFS8797K) and **M/s Ravi Realtors** (PAN-AAEFR0239C) had made bogus purchases of ₹ 6.86 crore and ₹ 7.21 crore from three hawala dealers but AO did not make any addition (AY 2011-12).

The Ministry accepted the observation (20 September 2016) stating that it was not ascertainable whether information regarding bogus purchases were made available on records at the time of passing order under section 263 of the Act. Suitable remedial action will be initiated in due course.

Audit is of the opinion that in the case of M/s Siddivinayak Marketing, there was evidence on record in the assessment files that the ITD had received requisite information about the bogus purchases from the sales tax department. However, the ITD did not make any additions or disallowances. The ITD needs to improve the system. The assessment of the accommodation entry providers (The Utkantha Group in this case) should have been used as a tool to obtain details and use the said evidence to disallow the purchases made by the beneficiaries after adducing all evidence including the flow back of funds from the entry providers. Lack of co-ordination and proper data sharing between respective AOs would result in loss of revenue to the Government exchequer. In case of Ravi Realtors, no action was taken even after it was pointed out in audit in March 2015.

5.9 Other compliance issues of suspicious purchases

We noticed miscellaneous issues of suspicious purchases where ITD did not make any disallowance or failed to make the correct disallowance. Five cases are given below:

5.9.1 In the case of **M/s Shree Ram Urban Infrastructure Ltd.** (PAN-AACCS0454P), the AO disallowed (March 2014) an aggregate amount of ₹ 38.43 crore during AY 2009-10 and 2010-11 on account of bogus purchases disclosed during the survey action (February 2013) and reduced the same from the work in progress but the same was not reduced from work in progress in subsequent AY 2011-12.

The Ministry accepted the observation (20 September 2016) stating that the assessee was following percentage completion method of accounting and has recognized revenues only in AY 2012-13, since less than 30 per cent of the project was completed. Therefore, though the closing WIP was inadvertently worked out by not considering the disallowances made in the assessment orders for AY 2009-10 and 2010-11, the same has no revenue impact on the income of the relevant assessment year i.e. AY 2011-12, as there was no sales in the AY 2011-12 and the revenue was not recognized in the said assessment year. Subsequently, when the revenues were recognized in AY 2012-13, the closing WIP was correctly worked out by considering the disallowances made in AY 2009-10 to AY 2012-13. However, in order to correct the inadvertent mistake occurred in the assessment order for AY 2011-12, necessary rectification will be carried out so as to reflect the closing WIP correctly.

Audit is of the opinion that the department assessed the case of AY 2011-12 without considering the reduction in WIP in the previous assessments. This was indicative of the fact that the department did not correlate their own records while framing the Assessment order. It cannot be said that the mistake did not have any tax effect. If the matter was not pointed in audit, the assessee would have been able to reduce the taxable profit by including the bogus purchases in the WIP in the subsequent AYs.

5.9.2 M/s Erica Healthcare Private Ltd. (PAN-AABCN5831E) had made purchase of ₹ 18.35 crore from 4 hawala dealers. The AO did not make any addition on the ground (March 2013) that the assessee had made circular trade in which ₹ 37.89 lakh was offered to tax (AY 2010-11). However, we noticed that the assessee had in fact booked a loss of ₹ 1.99 crores through circular entries with the hawala parties.

The Ministry accepted the observation (20 September 2016) stating that notice u/s 148 has been issued, scrutiny proceedings are underway, final report shall be submitted on completion of scrutiny.

5.9.3 M/s Gopal Krishna Papers Pvt. Ltd. (PAN-AAACG3597M) had made purchases of ₹ 4.89 crore from two hawala operators. AO did not make any disallowance in the assessment order pertaining to AY 2010-11 though the assessee made sale of ₹ 79.46 lakh only against the purchases of ₹ 4.89 crore. The assessee extinguished the liability of ₹ 2.77 crore by making adjustment in sundry debtors and unsecured loans without giving any cogent reason.

5.9.4 In the case of **M/s Indigo Edutainment Pvt. Ltd.** (PAN-AABCI2949E), ITD made an addition (March 2014) of unexplained purchase (AY 2008-09) from dummy company M/s Database Software Technology Pvt. Ltd. of ₹ 16.18 crore instead of actual amount of ₹ 42.13 crore booked in the accounts. Thus there was an underassessment of ₹ 25.95 crore. Besides, bogus purchase aggregating ₹ 82.05 crore from two more companies M/s Basant Marketing Pvt. Ltd. and M/s Himachal Futuristic Communications Ltd. was also not disallowed.

The Ministry accepted the observation (20 September 2016) stating that order under section 143(3)/263 has been passed on 18.03.2016 making additions of ₹ 112.97 crore of unexplained purchases.

5.9.5 In the case of **Mr. Siddarth Praful Mehta** (PAN-AEXPM2847Q), while computing bogus purchases for AY 2010-11, ITD inadvertently made disallowance of purchases of ₹ 1.40 crore (March 2013) pertaining to FY 2008+09 instead of ₹ 3.78 crore informed by MSTD against the purchases from hawala operators during FY 2009-10. Even this disallowance was not in

conformity with the figures reported by MSTD for FY 2008-09 and corrective action was required to be taken for AY 2009-10 also.

The Ministry accepted the observation (20 September 2016) stating that order under section 154 passed on 21.11.2013 wherein purchases were taken at ₹ 3.78 crore instead of ₹ 1.40 crore.

5.10 Additions set aside in appeal

We analysed 25 cases (*Appendix 5.2*) decided by ITAT and found that the additions made were set aside in 18 cases, three cases were returned for fresh decision and additions in four cases were partly sustained in the range of 6 to 20 *per cent* of the bogus purchases. The major reason for setting aside the additions was that the additions were made merely on the basis of information obtained from the MSTD without conducting any independent enquiries or detailed investigation.

Lack of suitable guidelines/instructions to strengthen the investigation, scrutiny process and evidence gathering mechanism covering whole chain of bogus transactions in coordination with authorities of the State Tax/Central Excise Departments to establish the additions led to their unsustainability and setting aside in appeal.

Ministry stated (20 September 2016) that there are adequate measures, provisions in the Income Tax Act to deal with and curb the practices of introducing bogus purchases, hawala transactions, etc. Further, effective monitoring would do the needful for the field authorities to act. Regional Economic Intelligence Committees (REIC) have been formed for better coordination gathering and exchange of information as well as dealing with the information and the defaulter in best possible ways. There cannot be uniform law to deal with such information and there is no need either as the Statute contains enough provisions to deal with them. The hindrance of actionable intelligence is being removed with the advancement of technology and provisions of the Act for gathering of information relating to the Specified Financial Transactions. There are provisions relating to levying of penalties and launching of prosecution in the suitable cases. The effective monitoring will tackle this problem also.

Audit findings however did not corroborate the optimism of the Ministry as the department did not carry out any meaningful investigation subsequent to the receipt of information from MSTD and merely made additions based on such information without adducing any evidence which could be upheld in the appellate forum.

5.11 Conclusion

Audit examination of ITD's manner of dealing with non reporting with unaccounted income and generation of black money with specific reference to case of fictitious sales and purchases reported in the public domain by MSTD revealed that the tools available at the disposal of the department have not been put to any effective use. The department did not even scrutinize all the assessees featuring in the list of MSTD indulging in giving accommodation entries for bogus purchases. The information regarding bogus purchases were not passed on to AOs who were assessing the beneficiaries when the entry providers were assessed. The current provisions have not acted as a deterrent as there are no disincentive for giving and receiving accommodation entries. Established companies have also resorted to practice of obtaining bogus purchases which shows that present system of gathering evidence and acting thereon is ineffective. The information received by the department is not complete and the information is being used selectively and many assessees go scot free without any action from the department. The present system of making adhoc disallowance would only lead to generation of black money through such fictitious sales and purchases⁹⁶.

96 Second Report of Tax Administration Reforms Commission headed by Dr. Parthasarathi Shome, furnished to Government of India on 26 September 2014