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Analysing 200% penalty implications on cash deposits

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Hon'ble Prime Minister, Sh. Narendra Modi on November 8, 2016 made one of his boldest moves by launching an aggressive assault on black money through demonetisation of existing Rs. 500 and Rs. 1,000 currency notes. Being seen as a surgical attack on black money, fake currency and corruption, the Hon'ble Prime Minister informed his fellow countrymen that the existing Rs. 500 and Rs. 1,000 notes could be deposited in their bank accounts till December 30, 2016.

Following the news, there has been a rush in public towards deposit of existing Rs. 500 and Rs. 1,000 currency notes in their bank accounts. However, Income Tax Department through a series of press releases has warned regarding levy of penalty at 200% of the tax amount in case where amount of deposit is not in line with the income returned.

In this article, the possibility for levy of penalty under section 270A of the Income Tax Act, 1961 ('Act') has been analysed in case where a person has deposited his unaccounted cash in his bank account and paid due tax thereon in the return of income for AY 2017-16.

The Finance Act 2016 in order to rationalize and bring objectivity, certainty and clarity in the penalty provisions, replaced the existing section 271 of the Act and inserted a new section 270A of the Act for levy of penalty in cases of under reporting and misreporting of income.

Sub-section (1) of the new section 270A of the Act provides that the Assessing Officer, CIT (Appeals) or the Commissioner may direct that any person who has **under-reported** his income shall be liable to pay a penalty in addition to tax, if any, **on the under-reported** income. Thus, trigger point for applicability of penalty under section 270A of the Act is under-reporting of income.

Thus, in order to discuss applicability of penalty in cases where tax has been paid, it is important to first analyse what constitutes under-reporting of income.

Under-Reporting of Income

Sub-section 2 of section 270A of the Act provides that a person shall be considered to have under-reported his income, if, *inter alia*, the **income assessed is greater than the income determined in the return processed under 143(1)(a)** of the Act.

Thus, there shall be under-reporting of income only in cases where income assessed during the course of assessment proceedings would be greater than income determined in the return processed under section 143(1)(a) of the Act. Since, the income determined in the return processed under section 143(1)(a) of the Act in normal circumstances would be same as the income returned by a person, the **penalty under section 270A of the Act could be levied only when income assessed would be greater than income returned by the person**. This position is further clarified by sub-section 3 of section 270A of the Act which provides for manner to calculate the under-reported income.

Rates of Penalty

Sub-section 7 of section 270A of the Act provides that the rate of penalty shall be 50% of the tax payable on under-reported income.

Further, sub-section 8 of section 270A of the Act provides in a case where **under-reported income is in consequence of any misreporting** thereof by any person, penalty levied shall be 200% of the tax payable on such under-reported income.

Thus, even for levy of penalty at 200% of the tax payable, it is important that the **there must be an under-reported income** which must be as a consequence of misreporting.

Levy of penalty where tax has been duly paid

As can be seen from above, for levy of penalty under section 270A of the Act, there must be under-reporting of income. Where there was no under-reporting of income, no penalty under section 270A (whether at 50% or 200%) could be levied.

Assume a person has unaccounted cash on which no tax was ever paid. Such a person deposits this unaccounted cash in his bank account in November 2016 and duly declares such additional income in his return of income for AY 2017-18. Tax at appropriate rate are paid in full on such income for AY 2017-18.

Now, his income determined in the return processed under section 143(1)(a) of the Act would include this unaccounted cash income [assuming there is no other cause for variation under section 143(1)(a)]. When the case for AY 2017-18 would be picked up for scrutiny by

income tax department, the Assessing Officer would not be able to make any addition on account of this cash deposited in bank account since the person would have already offered this income to tax in his return of income filed for AY 2017-18.

In such a scenario, the income assessed would not be greater than the income determined in the return processed under section 143(1)(a) of the Act (assuming there is no addition on any other account). Hence, in such cases, there would be no under-reported income. Thus, the basic condition for levying penalty under section 270A of the Act would not be triggered.

Reference is further drawn on [Circular No. 25 of 2016 dated June 30, 2016](#) issued by CBDT while providing clarifications on the Income Declaration Scheme, 2016 ('IDS'). In question no. 9 of the circular, the CBDT dealt with the question regarding the advantages of the IDS where past undisclosed income is disclosed as current income in the return of income to be filed for AY 2017-18 in place of declaration under IDS. The answer of CBDT, *inter alia*, provided for the following:-

“If anyone attempts to disclose past undisclosed income in the current year, he will have to explain the source of income and substantiate the manner of earning the said income. In case of disclosure under the Scheme, there is no need to explain the source of income.”

Thus, it may be noted that where income is disclosed in return of income for AY 2017-18, the person making such disclosure would have to explain the source of income and substantiate the manner of earning the said income.

However, even where such person fails to offer the source of such cash deposit, the Assessing Office may only declare such cash deposits to be an unexplained income under section 68 of the Act on which no slab benefit (in case of individual/HUF) or any deduction would be eligible as per section 115BBE of the Act.

However, the Assessing Officer would not be able to make any addition on account of such cash deposit as income in respect thereof would already have been offered to tax. Thus, in the absence of any under-reported income, penalty under section 270A of the Act would not be levied.

The aforementioned legal position is author's personal view based on reasons set out hereinabove. It is pertinent to mention that litigation on levy of penalty cannot be ruled out specifically in light of the fact that the CBDT has explicitly warned against declaration of past income in current year in its clarificatory circulars on Income Declaration Scheme, 2016. Hence, before resorting to declare previously undeclared money in current year, a person is advised to independently verify the legal position with his tax advisors.

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