

Issues in Assessment

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ISSUES IN ASSESSMENT

1. Penny Stock
2. Cash Credit (Loans & Share Premium)-Section 68
3. S 14A Disallowances
4. Cash Deposit during demonetisation
5. Bogus purchases

Penny Stock-

- Penny Stocks are those which trade at very low price and has a low market capitalization. While there is no simple definition, penny stocks in India generally trade at Rs 0.05 to Rs 10 per share.(Article on moneycontrol.com by Suresh KP
- Investing in penny stocks is a high risk. If you are a high risk investor.
- Penny stocks are those that trade at a very low price, have very low market capitalisation, are mostly illiquid, and are usually listed on a smaller exchange. Penny stocks in the Indian stock market can have prices below Rs 10. These stocks are very speculative in nature and are considered highly risky because of lack of liquidity, smaller number of shareholders, large bid-ask spreads and limited disclosure of information(Economic times

Crack Down – Straight from the top

- The Income Tax Department and Securities and Exchange Board of India (SEBI) have intensified the crackdown on penny stocks after the Prime Minister's Office (PMO) sent details of 80 scrips earlier this month.
- The Income Tax Department has begun taking action against 18 of the Maharashtra-based penny stock companies.
- The SEBI, on the other hand, is drawing up stringent rules for companies prone to price manipulation and widening the scope of Graded Surveillance Measures.(1300 NSE Scripts and 100 BSE Scripts)

(Moneycontrol.com, Nov 20th 2017)

Report of Directorate of Investigation, Kolkata identified **64811** beneficiaries involving bogus LTCG of nearly **Rs. 38,000 crores.**

SEBI Investigation and ban

- SEBI in its part investigated various companies and passed order to ban 1,500 entities who manipulated the stock prices of 12 listed companies (2017). These interim orders were ex parte and without hearing the party. They banned the parties to trade in stock market till investigations were over.
- However SEBI was not able to prove any manipulation of price on majority of the cases and the interim orders had to be withdrawn or were set aside by SAT. In a very few cases where direct evidence was found persons were punished.
- It was felt that SEBI could not investigate the tax evasion angle and hence the matter was send to the tax department with their findings. SEBI was also not entitled to attach the proceeds of such rigging as per law

DIT Kolkata and Delhi Reports

Broadly speaking there are two types of companies.

- I. An old already listed company, the entire shareholding of which is bought by the syndicate to provide LTCG entries. These are generally dormant company with no business and with accumulated losses. (Market transaction route)
- II. A new company which is floated just for the purpose giving LTCG entries. Such new companies are often floated after the initial booking is complete and the capital base is decided keeping in mind the entries to be provided. (Preferential Allotment route)
- III. Modus operandi explained and send to field formations to act. However substantive material which could be used not collected.

Evidence collected by department.

- The tax department reopened all cases where person had traded in penny stock scripts identified by SEBI and investigation teams at Kolkatta and Delhi.
- An effort was made to circulate a questionnaire which was to be asked to the assessee by issuing summon under 131
- The investigation and arguments of by department ,
 - like very high profit earned with very small investment and in a short time
 - Companies having no financial substance and bad financial status had huge price rise
 - No logical person would invest in such a company
 - The assessee had no knowledge about the company or knowledge about the financials of the company.
 - The purchase and sales is through a tainted broker who has been fined by SEBI for price rigging.
 - Singular transaction entered which is never repeated.
 - Statements are given by directors and brokers of certain companies stating that they have provided accommodation entries.
- The department has not been able to show any direct trail of money except in certain cases.

Earlier Positive decisions

- Smt. Jamnadevi Agrawal 328 ITR 656. Famous eating Joint had purchased shares of from Kolkata based broker and sold the same in name of the entire family. Broker gave statement that the entire transaction was bogus. The assessee produced all the evidence like shares, transfer form and the transactions of sale. Some of the transactions off market. Same broker used for the entire group. Court refused to apply probability held in favour.(23-9-2010)
- Mukesh Ratilal Marolia:-(7-9-11) Purchase of shares in cash from agriculture income, shown in balance sheet. The agriculture income assessed and accepted so also the balance sheet. Assessee produced share and transfer forms. The sale of shares from two brokers M/s Richmond Securities Pvt. Ltd. and M/s. Scorpio Management Consultants Pvt. Ltd. Not challenged.(Approved by supreme court 27-1-14)
- **No claim of penny stock, no proper investigation done.**

Shamim. M Bharwoni [20 16] 69 taxmann.com 65.-Against

- The Mumbai ITAT in Shamim M Bharwoni has held against the assessee disbelieving the purchase of shares in cash from Kolkata, the purchases were in cash and the source of funds was cash in hand and assessee could not explain why it was purchased in cash. He was also not able to explain as to how the cash was transferred from Mumbai to broker in Kolkata.
- The transaction of purchase were off market and not recorded in stock exchange. The share certificate or the transfer form was not provided. The assessee was not a client of the broker at the time of purchases.
- This was the only transaction in shares, demat of shares taken up just before the sale of shares.
- The evidence of sending shares for transfer to the company not accepted as the letter had some defects as per the member of ITAT. Entire purchase disbelieved as no transfer form or the photocopy of share certificate in physical form provided only broker note provided

Cases decided against the assessee- Sanjay Bimalchand Jain vs. ITO 89 taxmann.com 196.(BOM) (April 2017)

- The assessee purchased shares of two unknown companies. The address and signatories were same for two companies. The broker from whom shares purchased also had the same address as the company. The shares were purchased in cash by paying 65000/-
- The two companies were merged with a third company and the share of new company were received by the assessee in proportion.
- The purchase broker and the sales broker were in Kolkata and the assessee had no idea about the transaction besides paying and receiving money.
- The broker through whom sales were made did not respond to the notice of the AO to provide details of parties who had made purchases. The purchase broker also did not respond to notices issued by AO. The bank accounts were not provided.
- The AO held that the said transaction was a business transaction and taxed it as business income. This was confirmed by CIT(A), ITAT and HC.
- The assessee had indulged in a dubious share transaction meant to account for the undisclosed income in the garb of long term capital gain. While so observing, the authorities held that the assessee had not tendered cogent evidence to explain as to how the shares in an unknown company worth Rs.5/had jumped to Rs.485/- in no time.

Abhimanyu Soin vs. ACIT in ITA No. 951/Chd/2016, & ITO vs.

- The assessee purchased 800 shares of STL at a premium and total price paid was Rs 2,72,000. The company was then merged with a new company and assessee got 34000 shares which were sold for Rs 83,57,578/-.
- The purchases were made in cash through four separate cash payments to broker from Kolkata by assessee from Chandigarh. The purchases were off market transactions.
- The assessee was not in India during the period when shares were purchased. He had no knowledge of shares. The source of cash was claimed as tuition money which was not proved.
- The broker did give confirmation to notice under section 133(6). The purchases were however found to be bogus and the fact that the broker from Kolkata would send someone to collect cash in Chandigarh was found to be unbelievable.
- The court based on the human probability and the fact that the company had no actual financial substance confirmed the addition.

Recent cases in favour of assessee.

- Effect of a transaction which is supported by documentary evidence cannot be brushed aside on suspicion or probabilities without pointing out any defect therein – Puja Gupta v. ITO [ITA No. 6890/Del./2018; AY : 2014-15; Order dated : 2.4.2019]
- The claim of the assessee cannot be rejected based on mere conjectures unverified by evidence under the pretentious garb of preponderance of human probabilities and theory of human behavior by the department – Navneet Agarwal v. ITO [ITA No. 2281/Kol./2017; Assessment Year : 2014-15 Order dated : 2.4.2019]
- True it is that several suspicious circumstances were indicated by the AO but then, the findings as ultimately recorded by him had been based more on presumptions rather than on cogent proof. As found concurrently by the CIT(A) and the ITAT, the AO had failed to show that the material documents placed on record by the assessee like broker's note, contract note, relevant extract of cash book, copies of share certificate, demat statement, etc were false, fabricated or fictitious. The appellate authorities have rightly observed that the facts as noticed by the AO like the notice under Section 133(6) to the company having been returned unserved, delayed payment to brokers, and dematerialization of shares just before the sale would lead to suspicion and call for detailed examination and verification but then, for these facts alone, the transaction could not be rejected altogether, particularly in the absence of any cogent evidence – CIT v. Smt. Sumitra Devi – [ITA No. 54/2012 (Raj. HC)]

Suman Podar (2019) 106 CCH 0062 DelHC (17-9-19) (ITAT order 25-7-19)

- Preferential allotment of shares. Payment through A/c payee cheque. All evidences provided.
- The assessee provided proof of sale of shares in the form of contract note and bank statement where money is received,
- There was allegation that assessee was one of the beneficiaries of the penny stock trading.
- The script was listed by BSE as being involved in bogus LTCG /STCG company.
- In spite of huge profit the assessee had not embarked on any other share trading transaction with the broker.
- The assessee was not able to explain the huge movement of price or reason for investment.

Suman Podar (2019) 106 CCH 0062 DelHC

- The AO realized that the said company was a penny stock company about which the BSE had listed the company as used for generating bogus LTCG and STCG.
- **The broker who had sold shares for the company failed to provide details of parties who had purchased the shares.**
- The analysis of the company done by the ITAT members showed that no person would purchase such shares and the company was penny stock in which manipulation was carried out. The ITAT went in to the Balance sheet and identified that the company had not done any business and the PE ratio was negative for the last two years.
- The ITAT followed the decision of Udit Kalra ITA NO 220/2009 to reject the claim of assessee. A list of all judgments against the assessee were quoted.
- The above decision has now been upheld by the SC by rejecting the SLP filed by the assessee.
- **The case sets a new trend as there was no fault found with the documentation and the only issue was the huge movement of price without any reason.**

Recent cases in favour of assessee-[Vijayrattan Balkrishan Mittal vs. DCIT \(ITAT Mumbai\)](#) (1-10-2019)

Preferential issue of shares bought by payment through A/c payee chq. Evidence in the form of application form, allotment letter and share certificate provided.

The shares were shown in the balance sheet and no adverse observation about purchases of shares. The shares were then split.

The shares were sold through GEOJIT a popular broker having BSE licenses and registered with SEBI. The assessee was dealing in shares from last ten years.

The sale transactions of shares have suffered expenses like brokerage, service tax, STT, stamp duty, exchange and SEBI turnover charges, etc. which are specifically shown in the contract notes issued by the Broker.

The assessee and few 100 other entities who were effected by SEBI interim order were exonerated of all allegation by SEBI final order on 19-9-17

Vijayrattan Balkrishan Mittal

- The fact that a scam has taken place in some penny stocks does not mean that all transactions in penny stocks can be regarded as bogus.
- In deciding whether the claim is genuine or not, the authorities have to be guided by the legal evidence and not on general observations based on statements, probabilities, human behavior, modus operandi etc.
- The AO has to show with evidence the chain of events and live link of the assessee's involvement in the scam including that he paid cash and in return received exempt LTCG gains (Sanjay Bimalchand Jain 89 TM 196 (Bom) distinguished)

Differentiation between Suman Podar(Del) and Balkrishna Mittal (Mum)

- The cases have similar facts except the following which can be identified.
 - The Mittal case the assessee was dealing in shares for last ten years and the sale was through a well known broking firm.
 - The assessee in Mittal case was able to show that the seller identity cannot be identified even by his sale broker which is a fact not coming out of suman podar case.
 - The fact that the ITAT came to a conclusion that the financial were bad and no one would invest in such a script has not been rebutted by assessee with any logical conclusions.
 - The fact that BSE had identified the company and there were reports of wrong doing weighted in the mind of judges, though there was no evidence to link the assessee to the wrong doings nor was the assessee mentioned in the statements referred. This is not argued or not brought out in the order.

Deepak Nagar vs. DCIT (ITAT Delhi) (12-6-19)

- The allegation that the Co is a penny stock co whose share price has been artificially rigged by promoters/brokers/operators to create non-genuine LTCG is not sufficient.
- The AO has failed to bring on record any evidence to prove that the transactions carried out by the assessee were not genuine or that the documents were not authentic.
- No specific enquiry or investigation was conducted in the case of the assessee and/or his broker either by the INV Wing or by the AO during the course of assessment proceedings.
- The statements were not taken by the AO and were pre-existing *and same could not be sole basis of assessment without conducting proper enquiry and examination during assessment proceedings itself*
- The penny stock was also not subject to any action from SEBI (Udit Kalra 176 DTR 249 (Del) distinguished, Fair Invest Ltd 357 ITR 146 (Del) followed)

Arun Kumar vs. ACIT (ITAT Delhi) (5-11-18)

- It cannot be inferred that the assessee has manipulated the share price merely because it moved up sharply.
- The AO has to produce material/evidence to show that the assessee/brokers did price rigging/manipulation of shares.
- The AO must also show that the relevant evidence produced by the assessee in the form of bills, contract notes, demat statement, bank account etc to prove the genuineness of the transactions are false or fictitious or bogus.
- All judgements considered from all courts so a good compilation.
- The judge is one of the members who decided the Suman Podar case.

Suspicion, Surmises and conjectures cannot replace facts and evidence. (Land mark judgments)

- No addition can be made on the basis of surmises, suspicion and conjectures - Omar Salav Mohamed Sait [(1959) 37 ITR 151 (SC)]
- Suspicion howsoever strong cannot take the place of evidence - Umacharan Shah & Bros. v. CIT [37 ITR 271 (SC)]
- Assessment could not be based on background of suspicion and in absence of any evidence to support the same – Lalchand Bhagat Ambica Ram v. CIT [(1959) 37 ITR 288 (SC)]

Share capital introduction

Some issues with regard to NRA Iron and Steel and recent Mumbai ITAT decisions.

Onus to prove credits-Kale Khan Mohammad Hanif vs. CIT -[1963] 50 ITR 1 (SC)

- *S. 106 of Evidence Act- The information of the credits is specific to the assessee and hence he is to lead evidence about its identity, genuineness and creditability.*
- *SC:-“It is well established that the onus of proving the source of a sum of money found to have been received by the assessee is on him. If he disputes liability for tax, it is for him to show either that the receipt was not income or that if it was, it was exempt from taxation under the provisions of the Act. In the absence of such proof, the Income-tax Officer is entitled to treat it as taxable income”.*
- Similar finding was given by the Apex Court in case of **A. Govindarajulu Mudaliar vs. CIT – [1958] 34 ITR 807 (SC).**

“Any Sum found Credited” in section 68

- The term ‘any sum found credited’ also takes under its sweep any sum credited as
- share capital,
- share premium or share application money or
- any such amount by whatever name called (even sales)

[Refer **Sophia Finance Ltd** – 205 ITR 98 (Del);

CIT vs. Ruby Traders and Exporters Ltd. -263 ITR 300 (Cal);

CIT vs. Divine Leasing and Finance Pvt. Ltd. – 299 ITR 268 (Del)

J.M.J Essential Oil Company – 100 Taxman.com 181 (Himachal Pradesh)

Judgment of Lovely Exports 216 CTR 195

- *‘if the share application money is received by the assessee company from alleged bogus shareholders, whose names are given to the AO, then the Department is free to proceed to reopen their individual assessments in accordance with law.’*
- The court reduced the rigours of 68, after submission of the identity of the shareholder and provision of his PAN NO. The HC of Kolkata and Delhi however distinguished the judgment in CIT vs. Nipun Builders and Developers P. Ltd.-350 ITR 407(Del); CIT vs. Nova Promoters and Finlease (P) Ltd. -342 ITR 169 (Del.); CIT vs. Oasis Hospitalities Pvt. Ltd. -333 ITR 119 (Del.); Rajmandir Estates Private Limited vs PCIT -386 ITR 162 (Cal)
- However certain courts still follow the judgment **PCIT vs. Veedhata Tower Pvt. Ltd.** -403 ITR 415(Bom); **PCIT vs. Apeak Infotech** -397 ITR 148(Bom); CIT vs. Gagandeep Infrastructure (P) LTd._-394 ITR 680(Bom)
- However the said judgment has been diluted by the recent judgments.

NRA IRON & STEEL PVT LTD SC-412 ITR 161

- Assesse received 17.60 cr from 19 companies, 6 from Mumbai, 11 in Kolkata and 2 from Guwahati. The premium on shares was Rs 190. Each company had invested 90-95 lakhs,
- The assessee submitted that the share capital money was received through banking channel and it submitted confirmations, income tax return acknowledgments and bank accounts in respect of the investor companies.
- The AO issued summons u/s 131, however non appeared against the summons from the companies. Some companies had replied to the summons by filing their submission through dak. Some companies did not file any reply. The AO launched a investigation with the ROC of various cities to find out the status of the companies. Analysis of the same is tabulated in next slide.

NRA Iron an Steel – Analysis by AO

Companies to whom notice served but no response received	3
Company in respect of which the address was found to be incorrect and at new address, office was found to be closed	1
Companies in respect of which notice could not be served as investor-company was not available at the address and some other person owned the premises	2
Reply received through dak. Details as to cheque number and share capital and number of shares given. Further, detail as to return of income for the concerned year given which showed very meagre income in the range of Nil to Rs. 28000	9
Reply received through dak stating that it had applied for shares but did not specify how many shares and at what premium etc. Further, the company did not furnish bank statement and had returned meagre income	2

The AO further found that 4 companies in Mumbai and 2 companies in Gauwahati were found to be non-existent at the address furnished. No justification for high premium was provided. **The SC in these set of facts restored the AO order inspite of concurrent finding of CIT(A), ITAT and HC.** (none appeared in SC for assessee inspite of three oppourtunities.)

Way forward post NRA Iron & Steel

- The judgment of the Court as rendered in the impugned case, has to be considered in the light of the facts existing in the case. The Court itself, in para 15, states that in the facts of the present case, the assessee company failed to discharge the onus laid down u/s 68 of the Act.(refer : CIT vs. Sun Engineering Works (P) Ltd.198 ITR 297)
- Kolkata ITAT in Baba Bhotnath Trade & Commerce LTD ITA 1494/Kol/17 has considered NRA iron & steel and distinguished it from facts of the case, similarly in Ambika Metalchem Impex P.Ltd the Mumbai ITAT I.T.A. No.1676/Mum/2017 has distinguished the SC case.
- The amendment to S 68 now puts responsibility on the assessee to prove the source of source under the proviso(A Y 13-14 onwards). However the said proviso is prospective as per the Bombay HC in Gagandeep Infrastructure P Ltd.

Proving of capacity of the creditor

- It is common for the AO to state that the creditor assessee's return of income does not match with the loan provided by the said person and hence the creditworthiness is not proved.
- It is to be noted that the person's capacity to give loan has to be gauged from the wealth held by such person. If the person is able to prove from the bank account the source of the money given then the AO cannot rely only on the return of income. (**Mayawati case 338 ITR 563 Del**)
- It is the duty of the assessee to prove the creditworthiness of the party however besides the case of share capital under the proviso the assessee is not required to prove the source of source.
- Similarly the high premium cannot be the cause for disallowance as the charging of premium is the discretion of the directors of the company

[PCIT vs Chain House International (P) Ltd. 98 Taxman.com 47 (MP) approved by SC]. However 56(2)(viib) has been inserted to take away such liberty. This amendment has created lot of issues for start up companies whose valuation is based on future inflows of revenue.

Statement Recorded behind assessee back needs to be provided.

- It is well settled that any document relied upon by the AO for making an addition has to be supplied to the assessee and an opportunity should be provided to the assessee to rebut the same. In this case, general statements have been made by the AO and the addition is made based on generalizations. The assessee has not been confronted with any of the evidence collected in the investigation done by the DIT(Inv.) Kolkata. Evidence collected from third parties cannot be used against the assessee without giving a copy of the same to the assessee and thereafter giving him an opportunity to rebut the same – Prakash Chand Bhutoria v. ITO [ITA No. 2394/Kol./2017; A.Y.: 2014-15; Order dated 27.6.2018 (Kol. Trib)] (Also Kishanchand Chellaram 125 ITR 713)

ITO vs. Citymaker Builder Pvt. Ltd (ITAT Mumbai)

- During the course of the assessment proceedings it was observed by the A.O that the assessee company had accepted share application money of Rs.1,75,00,000/- during the year. 43,750/- Shares of Rs 10 with a premium of Rs 390/- were issued. 10000 shares were subscribed by promoter and 33,750/- share application was received from six companies.
- The assessee justified the premium by showing the net asset value.
- The reply against 133(6) was filed giving details called for.
- The allegation was against two companies who were alleged to be controlled by Shri Praveen Kumar Jain, an infamous accommodation entry provider.
- The AO questioned the fact that the assessee had not issued the shares for more than three and a half year and that the whole transaction was a sham.

ITO vs. Citymaker Builder Pvt. Ltd (ITAT Mumbai)

- The ITAT held that it was the duty of the assessee to prove the three limbs of the credit.
- The ITAT further observed that the companies had not provided the bank statements and other information sought in section 133(6). The AO had therefore sought the details from the assessee.
- The assessee had submitted the details in a half hearted manner and the banks statement in the case of these companies were not submitted from which the creditworthiness and genuineness could be ascertained. The CIT(A) had passed a summary order without considering these facts. The assessee had submitted the profit and loss return, balance sheet and schedules but had not submitted the bank statements.
- The AO should have carried out the necessary investigation by summoning the directors which is not done and hence following NRA Iron & Steel the matter is set aside to the AO

ITO 5(1)(1) vs Ambika Metachem Impex P Ltd

- The assessee received share application money of Rs 84 lakhs from four companies.
- The said companies from whom application money was received were alleged to be companies under the control of Shri Praveen Kumar Jain.
- The assessee in support of his claim submitted all the details and the notice under section 133(6) were replied to by the companies. The CIT(A) allowed the assessee's appeal.
- The factual matrix is different from NRA Iron & Steel and the assessee has discharged his liability and the AO has not carried out further investigation to bring any adverse finding .

Royal Rich Developers Pvt. Ltd vs. PCIT (Bombay High Court)-22nd July 2019

- No rational person with sound mind will invest huge amount in the share subscription of a paper/shell company having no worthwhile business/project in hand at such a huge premium.
- The assessee could not produce the shareholders. The summons issued to them were not attended to by majority of the investors. Those who responded could not explain the source of funds in their books, there was direct credit of exact amount which was then passed on to the company as share application.
- The onus is on the assessee to prove the genuineness of the transaction as well as creditworthiness of the share subscribers. The assessee was not able to prove creditworthiness of the creditors.
- The statement of the Director Mr. Faria was taken in search who admitted to the entire investment being bogus.
- The failure to produce the subscribers and statement of the director that the entire investment is bogus justifies the addition

Some Case Laws Relating to Penny Stock

In Favour of Assessee

- Arun Kumar V/S Acit, ITAT Delhi/2018
- South Yarra Holdings V/S ITO, High Court Bom/2019
- Rajeev Agarwal & Sons Vs ITO, Ward- 31(1) ITAT Del 2019
- Vidhi Malhotra Vs ITO, Ward- 2(5) ITAT Delhi
- Saurabh Mittal v/s DCIT ITAT Jaipur 2018
- Anita Agarwal Vs ITO, Ward - 34(3) ITAT Kol 2019
- Prakash-Bhutoria v/s ITO ITAT Kol 2018
- Deepa Agarwal Vs ITO, Ward - 22(4), ITAT Kol 2019
- Ramprasad-Agarwal-Vs-ITO, ITAT Mum 2018

Some Case Laws Relating to Penny Stock

Against the Assessee

- Sanjay Bimalchand Jain Vs PCIT HC Bombay 2017
- Sandeep Bhargava vs ACIT ITAT Delhi 2019
- Suman Poddar V/S ITO High Court Delhi 2019.
- Abhimanyu Soin v/s ACIT, ITAT Chandigarh 2016
- Smt M.K. Rajeshwari v/s ITO, Raichur, ITAT Bangalore 2018
- Ratnakar M Pujari v/s ITO, Mumbai, ITAT Mumbai 2012
- Usha Chandresh Shah v/s ITO, Mumbai, ITAT Mumbai 2011
- Mrs. Vidya Reddy v/s ITO, Chennai, ITAT Chennai 2017
- Shahmim Hingora v/s ITO , ITAT Pune 2018
- Pooja Ajmani v/s ITO, ITAT Delhi 2018
- Shri Sant Kumar v/s ACIT, ITAT Delhi 2018

Peak credit and other Issues u/s 68

When peak can be applied

When can peak credit be applied

- “The principle of peak credit is not applicable in case where the deposits remained unexplained under s. 68 of the Act. It cannot apply in a case of different depositors where there has been no transaction of deposits and its repayment between a particular depositor and the assessee.” *Bhaiyalal Shyam Behari vs. CIT* 202 CTR (All) 515.
- *Similar view is taken in CIT vs Vijay Agricultural Industries.& CIT vs D.K.Garg ITA 115/2005.*
- *However there is a view that peak is to be added even if there is addition of gross profit on the credit entries. CIT vs JRD.Stock brokers Pvt LTD (del) ITA 544/2005 following Kale Khan Mohammad Hanif Vs. CIT [50 ITR 1]*

Assessment of entry operators

- The assessment of entry operators provides a challenge as the entry provider or DD provider may not be able to provide all the details of the credits in the account.
- Cases of Mukesh Chokshi , court has added 0.15% as the profit margin (M/s Goldstar Finvest Pvt. Ltd. ITA No.4625/Mum/2005 and 5000/Mum/2005 order dated 28/03/2008, Richmond Securities Pvt. Ltd. (subsequently known as Mhanagar Securities Pvt. Ltd. and now known as Alag Securities Pvt. Ltd.) ITA No.4624/Mum/2005 and M/s Alpha Chemie Trade Agencies Pvt. Ltd. (ITA No.4999/Mum/2005) for Assessment Year 2002-03 along with the case of M/s Mihir Agencies Pvt. Ltd. (ITA No.4912/Mum/2005) order dated 30/05/2008.)
- Panwala Surat vs ACIT ITA NO. 608 /612/ AHD/ 2010 Assesse involved in cheque and draft discounting the ITAT held that 0.125% before allowance of expenses would meet ends of justice. Shri Sanjay R Shah vs ITO ITA NO 492/Ahd/2016 commission on cheque and draft discounting commission rate of 0.1%

Can cash sales be added using probability

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- the assessee, with the introduction of new product *Pan Shamama*, process of retail counter sale on test market basis was introduced and the product sold as over the counter sale.
- The AO disbelieved the said explanation for cash deposit to the tune of 3.12 crores. The sales were only for one month on trial basis and inspite of success there was no such sales shown after that month.
- The HC while considering the case looked at S 68 and held that the said amount will be covered by any other amount credited.
- The HC further held that the satisfaction of the AO with explanation has to be objective and referred to plethora of judgments and concluded as under
- “Applying the aforesaid principles, we notice that the authorities below found the explanation furnished by the assessee not to be satisfactory. What was found peculiar, which fact remains unexplained, as to why and how should be their transactions, in cash, only in a particular month of the only two years. Such transactions are of huge amount. It is not claimed that the product is seasonal.”

Section 14A

Issue of shares held as stock and disallowance of proportionate interest expenses

Section 14A read with rule 8D

- Section 14A disallows expenditure incurred in earning exempt income to be claimed as a deduction.
- Sub-sections (2) and (3) of Section 14A empower the assessing officer to determine the expenditure incurred by applying the prescribed method if:
 1. the assessing officer is not satisfied with the correctness of the claim of the assessee, or
 2. the assessee states that no expenditure was incurred by him in relation to the exempt income.
- Rule 8D introduced from A Y 2008-09 , to give guidelines to the AO as to calculate the amount of disallowance. Rule 8D not retrospective held by SC in Essar Teleholding LTD 401 ITR 445 & Godrej Boyce Mfg Co.Ltd. 394 ITR 449.

Rule 8D

- 1) Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with—
 - the correctness of the claim of expenditure made by the assessee; or
 - the claim made by the assessee that no expenditure has been incurredin relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2)
 - 2) *The expenditure in relation to income which does not form part of the total income shall be the aggregate of following amounts, namely*
 - i. the amount of expenditure directly relating to income which does not form part of total income; and*
 - ii. an amount equal to one per cent of the annual average of the monthly average of the opening and closing balances of the **value of investment**, income from which does not or shall not form part of total income*

Provided that the amount referred to in clause (i) and clause (ii) shall not exceed the total expenditure claimed by the assessee
- (Sub rule 2 amended from 2-6-2016 A Y 17-18)*

Shares held as stock in trade.(Issue -1)

- It was contended that the shares held as stock in trade were held to earn taxable profit and that any dividend earned is only incidental and therefore the same cannot attract disallowance under section 14A.
- The term used in Rule 8D(2) is “value of investment” and therefore the rule would not apply to shares held as stock in trade.
- The said issue is highly debatable and there were decisions in both sides. (DCIT vs M/S India Advantage Fund ITA 1131 of 2013 , State Bank of Patiala 391 ITR 218 & CCI LTD vs JCIT (Kar). Whereas the Delhi HC in the case of Max India and Daga Capital held against the assessee. The matter then reached SC in Maxcopp Investments LTD.

Maxcopp Investments Ltd 402 ITR 640.

- The issue before the honourable SC was to decide whether the purpose of holding the shares would be relevant while considering the applicability of section 14A.
- There were two parts to the question one was with regards to Max India (Del HC) which was holding shares as strategic investments and hence claimed that the same was for business purpose of holding controlling interest and the other in State Bank of Patiala(P& H) where the shares were held as stock in trade and the purpose of holding was only to earn taxable income. The dividend if any was only incidental.
- It was argued that the assessee would not incur additional expenditure whether the dividend was earned or not.

Maxcopp Investments Ltd conclusions. Para 38 & 39

- At the same time, we do not agree with the test of dominant intention applied by the Punjab and Haryana High Court, which we have already discarded.(Para 38 line 7 from top)
- However, by virtue of Section 10 (34) of the Act, this dividend income is not to be included in the total income and is exempt from tax. This triggers the applicability of Section 14A of the Act which is based on the theory of apportionment of expenditure between taxable and non-taxable income as held in Walfort Share and Stock Brokers P Ltd. case.
- Therefore, to that extent, depending upon the facts of each case, the expenditure incurred in acquiring those shares will have to be apportioned.
- This would show that the honourable SC has held that the S.14A would apply to shares held as stock in trade.

Maxcopp –Para 40

- The Honourable SC in this para distinguishes the facts of Maxcopp from the State bank of patiala and holds that the dividend is earned as a quirk of fate.
- The court points out that when the assessee holds controlling interest he is aware and conscious of the fact that the investment will earn dividend. There is a certainty of earning. In contrast the shares held as stock in trade the dividend may not be earned.
- The court points out that the AO itself has restricted the disallowance to the amount of income. However the CIT (A) has disallowed the entire expenditure worked out under rule 8D which is above the income. The court holds that this view is not tenable and the ITAT has rightly set aside the CIT(A) view and the High court has also rightly confirmed the said action of ITAT.
- However the SC seems to have missed the fact that the ITAT has also reversed the view of the AO and held that no disallowance is to be made under S 14 A following the principal purpose test. The court adds “though law in this respect has been clarified hereinabove” which is para 39.

The confusion- about the principal to follow

- Whereas the SC in para 38 and 39 completely discards the concept of dominant purpose test and states that proportionate disallowance is to be made.
- However, the SC in para 40 goes and distinguishes the shares held as stock in trade and how it is different from cases of shares held for controlling interest. It further confirms the finding of Punjab and Haryana High court that if the shares are held as stock in trade then section 14A does not apply dismissing the appeal of the department.
- Is the proportionate disallowance to be made under S 14A? Or para 40 clearly says no in final word from court.

Nice Bombay Transport Co LTD ITAT DEL

- In this case the ITAT was considering the disallowance of interest u/s 14A being related to earning exempt income. The shares were held as stock in trade.
- The ITAT considered the SC judgment of Maxcopp Investment Ltd. Para 39 & 40 (reproduced it) and concluded that the shares held as stock in trade are different from shares held for holding controlling interest. That SC in para 40 has clearly laid down that dividend is earned as quirk of fate and hence no disallowance under section 14A needs to be made.
- “It is, therefore, clear that though not the dominant purpose of acquiring the shares is a relevant for the purpose of invoking the provisions under section 14 A of the Act, the shares held as stock in trade stand on a different pedestal in relation to the shares that were acquired with an intention to acquire and retain the controlling interest in the investee company.” (para 16 last four lines)
- Thus the ITAT has done a literal interpretation of the para and followed the SC judgment in the above matter. Is the issue now settled?

Lally Motors India Pvt Ltd. ITA. 218/Asr/2017 (Issue -2)

- Can S 14A be invoked even if there is no exempt income to disallow expenses?
- Various courts have held that if there is no exempt income for a particular year then no disallowance needs to be made u/s 14A, Cheminvest Ltd. (in ITA No. 794/2014, dated 02/9/2015)
- **Avshesh Mercantile P. Ltd. vs. Dy. CIT [ITA No. 5779, 5780, 6032/2012/Mum Bench 'F']**
- **M/s Delite Enterprises ITA No. 110 of 2009 dt. 26-2-2009 BOM HC,**
- **CIT-1 vs Corrtch Energy PVT LTD 372 ITR 97 Guj HC)**
- **This was based on the fact that the section 14A provided for the term “income which does not form part of the total income under this Act” it was interpreted that if there is no income which does not form part of total income in a particular year then section 14A would not apply.**

Lally Motors India Pvt Ltd.& Maxcopp judgment

- SC in Maxcopp in para 40 held as follows

“We note from the facts in the State Bank of Patiala cases that the AO, while passing the assessment order, had already restricted the disallowance to the amount which was claimed as exempt income by applying the formula contained in Rule 8D of the Rules and holding that section 14A of the Act would be applicable. In spite of this exercise of apportionment of expenditure carried out by the AO, CIT(A) disallowed the entire deduction of expenditure. That view of the CIT(A) was clearly untenable and rightly set aside by the ITAT. Therefore, on facts, the Punjab and Haryana High Court has arrived at a correct conclusion by affirming the view of the ITAT, though we are not subscribing to the theory of dominant intention applied by the High Court.”

The SC accepts the contention that the disallowance of expenses have to be restricted to the income earned and therefore if no income no disallowance.

Lally Motors India Pvt Ltd.-finding of ITAT

- The disallowance of expenses under S14A has nothing to do with whether income is earned or not. The AO though had referred and asked for details of S 14A disallowance and why no disallowance is made, there was complete absence of examination. (The assessee had apparently used interest bearing funds for purchase of shares)
- The allegation was that the AO had not followed circular 5/2014 though it was binding on him. Circular provided that S 14A would be applicable even there was no exempt income.
- The ITAT was of the view that the decision of the non jurisdictional HC in this case Del HC would not be binding on the AO and he should follow the circular as that is binding on him. Para 4.2

Lally Motors India Pvt Ltd.-Conclusion

- The ITAT then refers to the theory of apportionment in Walfort Share & Stock Brokers P. Ltd. [2010] 326 ITR 1 (SC) & Godrej & Boyce Mfg. Co. Ltd. v. Dy. CIT [2010] 328 ITR 81 (BOM)
- The ITAT then goes to the judgment of Apex Court in CIT v. Rajendra Prasad Mody [1978] 115 ITR 519 (SC). The said judgment was with regard to the S 57(iii), in this case the assessee had claimed a loss from income from other sources which was disallowed and the SC had allowed the loss.
- The Tribunal then refers to Maxcopp para's 3, 8, 30, and 40. The tribunal however does not bring out the portion of para 40 reproduced above nor does it refer to the State bank of Patiala judgment confirmed by SC. It draws certain arguments from the judgment to conclude that the SC also supports such view. Thus it holds that S 14A would apply whether there is income or not.
- Surprisingly, the issue before the court was that of applicability of S 263 as in para 2 and the decision in para 6 is also given with regard to this aspect . Thus can it be said that this obiter dicta and hence no binding principal can be drawn from this? Ref GVK Project and Technical Service LTD 106 Taxman.com 180 (SLP dismissed) Oil Industries Development board 103 Taxman.com 326 SC SLP Dismissed

Interest free funds available with the assessee(Issue 3)

- The courts have over the years held that if there are enough surplus funds available with the assessee it is to be assumed that the investment to earn exempt income is from such funds. HDFC BANK (BOM) 67 taxman.com 42, Reliance Utilities & Power LTD (BOM) 178 taxman 135.
- SC in Reliance Industries LTD and Sintex Industries LTd have rejected the SLP of department. The cases were with regard to surplus funds available with the assessee.
- However there is the old Kolkata HC judgment in the case of Dhanuka & Sons 339 ITR 319 (Cal) which provided that the assessee has to prove through documentary evidence that the funds invested by him have moved from interest free funds as that is the information which the assessee possesses.
- Is the issue covered in view of the high court and SC SLP dismissed?

Is the applicability of Rule 8D to be made in all cases? (Issue 4)

- Maxcopp Investment LTD SC
- “41) Having regard to the language of Section 14A(2) of the Act, read with Rule 8D of the Rules, we also make it clear that before applying the theory of apportionment, the AO needs to record satisfaction that having regard to the kind of the assessee, suo moto disallowance under Section 14A was not correct. It will be in those cases where the assessee in his return has himself apportioned but the AO was not accepting the said apportionment. In that eventuality, it will have to record its satisfaction to this effect. Further, while recording such a satisfaction, nature of loan taken by the assessee for purchasing the shares/making the investment in shares is to be examined by the AO.”
- PCIT v. Gujarat State Fertilizers And Chemicals Limited 108 Taxman.com 560(SLP dismissed)

Applicability of 14A to expenses incurred against income from firm(Issue 5)

- If expenses are claimed against income from firm or if the assessee is having income from proprietorship firm and income from patnership firm.
- The department is likely to raise the issue of S 14A disallowance on account of the firm profit being exempt under section 10(2A).

Cases in favour of disallowance, **Popular Vehicles & Services Ltd (325 ITR 523) (Ker HC) (2010)-Vishnu AnantMahajan v. ACIT (137 ITD 189) (Ahd. SB) (2012).**

Cases having contrary view, **SudhirKapadia v. ITO (ITA No. 7833/Mum/2003), Hitesh D. Gajariav. ACIT (ITA No.983/Mum/2007)**

With the confirmation of Godrej Boyce case by SC applicability of 14A is better view

Can the disallowance be lower than 8D(iii) less than 0.5%/ 1% of investment

- Reliance Capital Asset Management Ltd vs DCT 3(3). 8625/mum/2010, ITA 4459/mum/2012 In this case disallowance restricted to a lumpsum figure of 3,50,000/-.
- Jindal Drugs Pvt Ltd ITA NO 1694/m/17
- In this case also it was held that the disallowance should be restricted to 5% of the exempt income and rule 8D(iii) is not to be followed based on facts of the case.
- However one will have to show that the disallowance as per the working of Rule 8D is an unrealistic figure considering the facts of the case.

Cash deposits in Demonetisation

Issues and show cause notices.

Demonetisation and Benami Transactions:

In

APPELLATE TRIBUNAL FOR PROHIBITION OF BENAMI PROPERTY TRANSACTIONS ACT, NEW DELHI

• **G. Bahadur vs. K. Visakh, ACIT, Chennai(Oct 2018)**

The appellant had received an amount of Rupees 50,000 in cash from said Trust as advance salary. The appellant deposited the entire amount of Rs. 50,000 in his bank account, which was subsequently withdrawn by him and consumed for his personal purposes.

The initiating Officer (I.O.) was of view that the Chairman had forced his employees to distribute, deposit and retain his own money in demonetised currency in the guise of loan received, which had to be repaid after some time in new currency as per his convenience, and, thus, held the chairman to be the beneficial owner and appellant as benamidar thereafter, attaching his salary bank account.

It was concluded,

That the authorities have **failed to discharge the burden of proof**. The authority has purely gone on the premise that cash is transferred from one person to another, with an object to defeat ,demonetization. This is insufficient to establish a "*benami*" transaction.

IMPACT OF DEMONETIZATION

Judgements with respect to unexplained Cash

In the following cases

Chunilal Rastogi vs. CIT [1955] 28 ITR 341 (Pat.)

Anil Kumar Singh vs. CIT [1972] 84 ITR 307 (Cal.)

M. L. Tewary vs. CIT [1955] 27 ITR 630 (PAT.)

It was observed that the,

- Onus is on assessee to prove positively the source and nature of an amount received by him in accounting year, and if he fails to discharge that onus, income-tax authorities are entitled to draw an inference that amount received was of an income nature.
- Where assessee not having satisfactorily proved source and nature of amount which he en-cashed on demonetization, revenue authorities were perfectly justified in drawing an inference that said sum was of an income nature.

IMPACT OF DEMONETIZATION

Affidavit of payers:

Whereas in the case of

Mehta Parikh & Co. v. CIT [1956] 30 ITR 181 (SC).

When the assessee submitted books of account showing relevant entries showing payment being made to them which resulted in cash in its books and also submitted affidavits of payers, Revenue authorities cannot hold that it was not possible that all payments after a particular date were being made in evident multiples. No addition can be sustained based on pure surmise.

Cash in hand in books:

Where amount en-cashed on demonetization was part of cash balance in the books of account, AO can not disbelieve a part of such cash balance as being not of specified denominations, when the books are not rejected.

Lalchand Bhagat Ambica Ram vs. CIT [1959] 37 ITR 288(SC).

Denomination wise bifurcation of cash not an excuse for demanding income source:

Where there was sufficient balance on date of deposit, Assessing Officer can not make additions of part of amount for want of details of receipts of some of high denomination notes. There was no justification for adding a portion of amount tendered by assessee for encashment of high denomination notes as income of assessee from undisclosed sources for alleged failure of assessee to furnish source of acquisition of amount in such notes.

- -Narendra G. Goradia vs. CIT [1998] 234 ITR 571 (Bombay)
- -Lakshmi Rice Mills vs. CIT [1974] 97 ITR 258 (Pat.)

Further in

Gur Prasad Hari Das vs. CIT [1963] 47 ITR 634 (All.)

the AO increased the income of the assessee only on the basis that the Cash balance was covered by only high denomination notes. It was held that:

It was possible that even in a cash balance of a very large amount there may be no high denomination notes at all. Equally it was possible that even, in a cash balance of a small amount almost the entire cash balance may be made up only of high denomination notes.

When both the possibilities were there, it could not be said that those or any of them represented the income of the assessee from some undisclosed source.

To further elaborate the above point in

Kanpur Steel Co. Ltd. v. CIT [1957] 32 ITR 56 (ALL.)

The assessee's explanation with regards to the logic of maintaining cash balance in high denomination was accepted and the decision was in favour of the assessee.

Unexplained Cash in Old Notes after Cut- off dates:

This issue was addressed in

CIT vs. Andhra Pradesh Yarn Combines (P.) Ltd. [2006] 282 ITR 490 (Karnataka)

Where the day on which unexplained cash was found was after the cut- off date.

High Court ruled in the favour of assessee since the cash that was found after the cut-off date held no monetary value and was considered as scrap paper and hence it could not be said that the assessee was in possession of unexplained money.

Cases where books of accounts are not maintained:

Where assessee was not maintaining any account books, bank statement could not be construed to be a books of account maintained by her; merely on basis of information that assessee made a 'cash deposit' in her saving bank account, no addition could be made as unexplained cash credit

ITAT Mumbai bench 'B' Mehul V. Vyas vs. ITO, Mumbai

Whereas in case of Sudhir Kumar Sharma (HUF) vs. CIT III Ludhiana (High Court of Punjab and Haryana) has ruled in the favour of the department and the income of the assessee has been increased based on the cash deposits in the bank by invoking sec. 68. The assessee had file a Special Leave Petition against HC order which was dismissed by the Supreme Court.

In case where books of accounts are maintained but the assessee needs extra time to provide the same, and after allowing the assessee fails to provide the required records, the judiciary has ruled the judgement against the assessee by using the above-mentioned case of Sudhir Kumar Sharma (HUF). For ref:

- **Arunkumar J. Muchhala vs. CIT (High Court Mumbai)**

Bogus purchases – latest case laws

- [**CIT vs. Odeon Builders Pvt. Ltd \(Supreme Court\)-21-8-19 itatonline.org**](#)
- Disallowance cannot be made solely on third party information without subjecting it to further scrutiny.
- The assessee has prima facie discharged the initial burden of substantiating the purchases through various documentation including purchase bills, transportation bills, confirmed copy of accounts and the fact of payment through cheques, & VAT Registration of the sellers & their Income Tax Return.
- The AO has also not provided a copy of the statements to the assessee, thus denying it opportunity of cross examination

Bogus purchases –Recent case laws

- [PCIT vs. Paramshakti Distributors Pvt. Ltd \(Bombay High Court\)](#)
- Despite admission by the assessee that the purchases were mere accommodation entries, the entire expenditure cannot be disallowed. Only the profit embedded in the purchases covered by the bogus bills can be taxed. The GP rate disclosed by the assessee cannot be disturbed in the absence of incriminating material to discard the book results
- Total sale cannot be regarded as profit and the sale proceeds cannot be added as income - **Manmohan Sadani v. CIT [304 ITR 52) and CIT v. BalchandAjit Kumar 263 ITR 610 (MP HC).**
- **M/S Mohd. Haji Adam & Co. ITA No. 1004 of 2016**, The court held that the addition can be made only of the difference of GP rate between the normal and the bogus purchases. Mumbai ITAT has accepted the said judgment in many cases. However, the ITAT sets aside the case for verification to AO. [V.R.Enterprises vs. ITO \(ITAT Mumbai\)](#)



THANK YOU

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