

# ISSUES ON PENNY STOCK

**Presented by: CA. Sanjay K. Agarwal**

**Email: [agarwal.s.ca@gmail.com](mailto:agarwal.s.ca@gmail.com)**

# WHAT IS PENNY STOCK?

- Trade at a very low price,
- Small market capitalization
- Mostly illiquid
- Usually listed on a smaller exchange.
- Speculative in nature
- Highly risky
- In Indian stock market, they can have prices below Rs 10



# HOW THE PENNY STOCKS SCAM WORKS

A flowchart explaining how black money is converted into white using long term capital gains tax exemption and penny stocks

A person, say X, seeking to launder unaccounted money, approaches an entry operator—an agent who controls a large number of paper/shell companies.

The entry operator asks X to buy shares of an illiquid listed penny stock. Alternatively, the agent may arrange for a private placement/preferential allotment of shares in the same company. Typically, these shares are allotted or bought at a very low price—say X buys 100 shares in company A at Re1, spending Rs100.

Once a year is over (that's how they get capital gains tax exemption), the operator asks X for the unaccounted cash. This cash is routed to the books of various paper companies, say B, C and D.

The operator starts rigging the price of the listed company through circular trading over a year. The prices of shares are increased to some pre-determined level with the help of the same set of buyers and sellers. Let's say the price of these shares touches Rs40; therefore, the total value of A shares with X equals Rs4,000.

Then the operator asks X to place a sell order of his shares at a particular lot size and time. Simultaneously, he asks B, C, and D to place buy orders for company A shares, matching X's sell orders.

Once the trade is executed, X is able to show Rs4,000 (less initial outlay of Rs100) as a long-term capital gain. This, which is exempt from tax, is black money converted into accounted-for money.

# HOW THIS ALL STARTED ??

- In Finance Act, 2004, Government of India has introduced the Security Transaction Tax (STT) both at the time of purchase and sale, irrespective of profit or loss emanating from transaction, as a measure to avoid the capital gain tax.
- As a natural corollary to same, STCG emanating from share transaction was revised from 30% to 10% (which was later on revised to 15% by Finance Act, 2008) and LTCG was made exempt by introduction of section 10(38).
- However, this wise move on part of department, later on become, a major route for tax evasion, as a syndicate of Operator, broker & scrip promoters, came together and started to use this method for providing bogus long term capital gain/loss.

# HOW THE FRAUD CAME IN LIGHT

- A Search & Seizure action was conducted by the Directorate of Income Tax [Investigation], Kolkata on 02/07/2013 on Anand Sharma and Janardan Chokhani Group, and subsequently on the Deepak Patwari's Destiny Security Ltd Group. As a result of the said search & seizure action, it was gathered that certain persons had been involved in manipulation of the market price of shares of some companies listed on the BSE namely ***M/s Pearl Electronics ltd, Shree Shaleen Textiles Limited, Cressanda Solutions Ltd, etc.,*** in order to provide entries of bogus Long Term Capital Gains to the interested persons hereinafter referred to as 'beneficiaries'.
- After then, the Directorate of Investigation, Kolkata, has undertaken the accommodation entry of Long Term Capital Gain (LTCG) investigation on a larger scale and identify a large number of beneficiaries who have together taken a huge amount bogus entries of LTCG. A detailed investigation report named "Project bogus LTCG/STCL through BSE listed penny stocks" was made. On the basis of statements recorded and findings of the investigations huge amount of beneficiaries were detected and reported to Assessment wings.
- **As per report, estimated, 64811 beneficiaries were involved in bogus LTCG of nearly 38,000 crores.**

# RESULTS OF KOLKATA INVESTIGATIONS

- Total **84 BSE listed Companies** have been identified as **penny stocks**.
- A Total of more than **60 thousand PAN numbers of the beneficiaries** were identified which is being reported to assessment wings through the DGIT,s.
- The report further covered more than **5000 paper/shell companies**, also known as “Jamakharchi” companies, which are involved in providing bogus accommodation of various kinds.
- Statements for most of the directors of companies had been recorded under oath.
- The department also prepared **cash trail of Rs. 1570 Crore**. The case trail reflected how unaccounted/undisclosed cash of beneficiaries was being routed through this modus to convert black money into LTCG.
- The investigating team had followed the money trail from the point it is being deposited to the undisclosed proprietorship bank accounts, to the accounts of share brokers. Then they recorded statements of share brokers where they have accepted that cash has been used for providing accommodation entry of bogus LTCG.

- 84 BSE listed companies identified as penny stocks (As per Report)**

SL No.	SCRIPT CODE	FULL NAME of PENNY STOCK
1	531517	Alang Industrial Gases Ltd
2	531720	Alpha Graphic India Ltd
3	538423	Alps Motor Finance Ltd
4	512355	Anukaran Commercial Enterprises Ltd
5	590122	Ashika Credit Capital Ltd
6	530479	Atlanta Infrastructure And Finance Ltd
7	531570	Blazon Marbles Limited
8	508939	Blue Circle Services Ltd
9	531900	Ccl International Ltd
10	535142	Channel Nine Entertainment Ltd
11	535267	Comfort Fincap Ltd
12	526141	Compact Disc India Ltd
13	512361	Cupid Trades & Finance Ltd
14	503637	Dhanleela Investments & Trading Company Ltd
15	532903	Dhanus Technologies Ltd
16	534839	Eco Friendly Food Processing Park Ltd
17	512207	Effingo Textile & Trading Limited
18	531502	Esaar (India) Ltd
19	534927	Esteem Bio Organic Food Processing Ltd
20	511369	First Financial Services Ltd
21	535431	Gcm Securities Ltd

22	531055	Gfl Financials India Limited
23	531463	Global Infratech & Finance Limited
24	538180	Gold Line International Finvest Ltd
25	509024	Golden Legand Leasing & Finance Ltd
26	531737	Greencrest Financial Services Limited
27	535217	Hpc Biosciences Ltd
28	534734	Icvi Chemicals Ltd
29	538422	Jackson Investments Ltd
30	511092	Jmd Telefilms Industries Ltd
31	507968	Jolly Plastic Industries Ltd
32	511357	Kailash Auto Finance Ltd
33	506938	Kappac Pharma Ltd
34	530255	Kay Power And Paper Ltd
35	530701	KDJ Holidayscapes And Resorts Limited
36	506113	Lifeline Drugs & Pharma Ltd
37	526045	Luminaire Technologies Ltd
38	511082	Maa Jagdambe Tradelinks Limited
39	531689	Mahavir Advanced Remedies Ltd
40	512191	Mishka Finance And Trading Ltd
41	513305	Moryo Industries Ltd
42	530557	Ncl Research & Financial Services Ltd

43	505525	Parichay Investments Ltd
44	511421	Pine Animation Limited
45	535514	Prime Capital Market Ltd
46	505502	Ps It Infrastructure & Services Limited
47	530561	Radford Global Limited
48	512319	Rajlaxmi Industries Ltd
49	531228	Rander Corporation Ltd
50	504335	Rutron International Ltd
51	530657	Global Securities Ltd
52	531800	Sheetal Bio-Agro Tech Ltd
53	512105	Shree Nath Commercial & Finance Ltd
54	505513	Shree Shaleen Textiles Limited
55	512048	Splash Media & Infra Ltd
56	531307	S R K Industries Ltd
57	512075	Suchak Trading Ltd
58	508969	Sulabh Engineers & Services Ltd
59	506615	Sunrise Asian Limited
60	512311	Surabhi Chemicals & Investments Ltd
61	531411	Tuni Textile Mills Ltd
62	504358	Turbotech Engineering Ltd
63	537582	Unishire Urban Infra Ltd

64	531831	Unisys Softwares & Holding Industries Ltd
65	519273	Unno Industries Ltd
66	512067	Vishvjyoti Trading Ltd
67	526671	Matra Kaushal Enterprise Limited
68	535204	Pearl Agriculture Ltd
69	512379	Cressanda Solutions Ltd
70	501945	Dhenu Buildcon Infra Ltd
71	531465	Nouveau Global Ventures Ltd
72	511016	Premier Capital Services Ltd
73	512417	Trinity Tradelink Limited
74	538295	Golden Bull Research & Growth Limited
75	511064	Eins Edutech Limited
76	504369	Grandma Trading & Agencies Ltd
77	535205	Pearl Electronics Ltd
78	532031	Sarang Chemicals Ltd
79	531272	Nikki Global Finance Ltd
80	531597	Midland Polymers Ltd
81	511690	Warner Multimedia Ltd
82	512585	Karma Industries Ltd
83	538684	Encash Entertainment Ltd
84	511668	Fact Enterprise Ltd.



Digit Wise	No. of Pan	Amount (Rs)
Mumbai	17344	1223392,20,545
Kolkata	12236	671804,06,328
Delhi	6632	609972,97,795
Ahmedabad	6962	241851,44,408
Lucknow	3996	221427,35,005
Chandigarh	2519	165985,63,664
Bhopal	3118	151807,09,899
Jaipur	3471	150909,93,477
Bengaluru	1619	107038,20,659
Hyderabad	2604	105012,00,292
Chennai	1790	90944,04,614
Patna	1133	42251,14,570
Pune	399	514,21,00,307
International Taxation	136	2757,35,307
Kochi	187	2172,38,411
<b>Total</b>	<b>64811</b>	<b>3838746,85,281</b>

**CAPITAL GAIN  
SIDE OR SALE  
SIDE  
BENEFICIARIES  
(AS PER THE  
REPORT)**

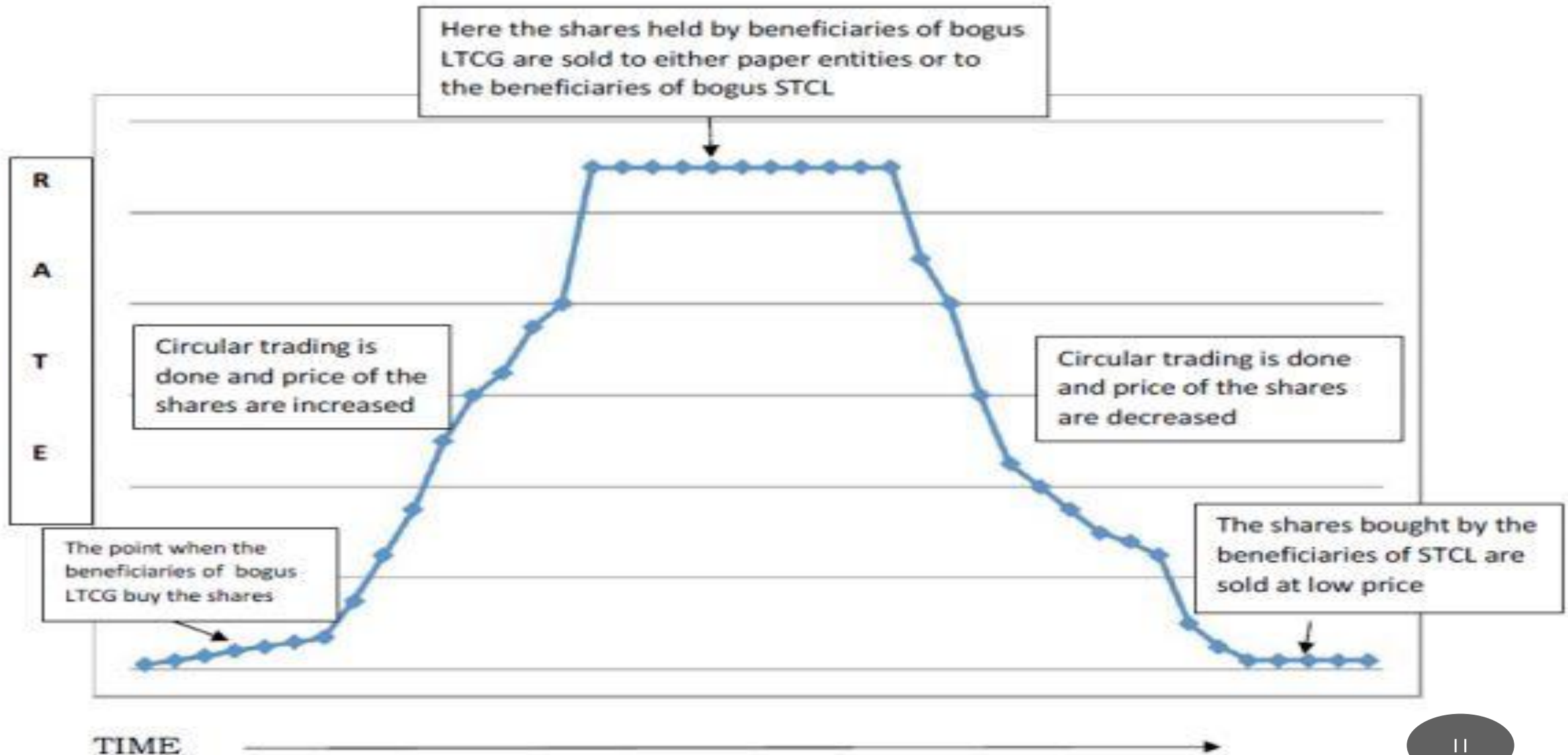
Contd..

**SHORT TERM  
CAPITAL LOSS  
OR PURCHASE  
SIDE  
BENEFICIARIES  
/  
JAMAKHARCHI  
PROVIDERS  
(AS PER THE  
REPORT)**



Digit Wise	No. of Pan	Amount (Rs)
Mumbai	17344	1223392,20,545
Kolkata	12236	671804,06,328
Delhi	6632	609972,97,795
Ahmedabad	6962	241851,44,408
Lucknow	3996	221427,35,005
Chandigarh	2519	165985,63,664
Bhopal	3118	151807,09,899
Jaipur	3471	150909,93,477
Bengaluru	1619	107038,20,659
Hyderabad	2604	105012,00,292
Chennai	1790	90944,04,614
Patna	1133	42251,14,570
Pune	399	514,21,00,307
International Taxation	136	2757,35,307
Kochi	187	2172,38,411
<b>Total</b>	<b>64811</b>	<b>3838746,85,281</b>

# SUMMARY OF MODUS OPERANDI



# SOME TRADING PATTERNS (Extracts From The Report)

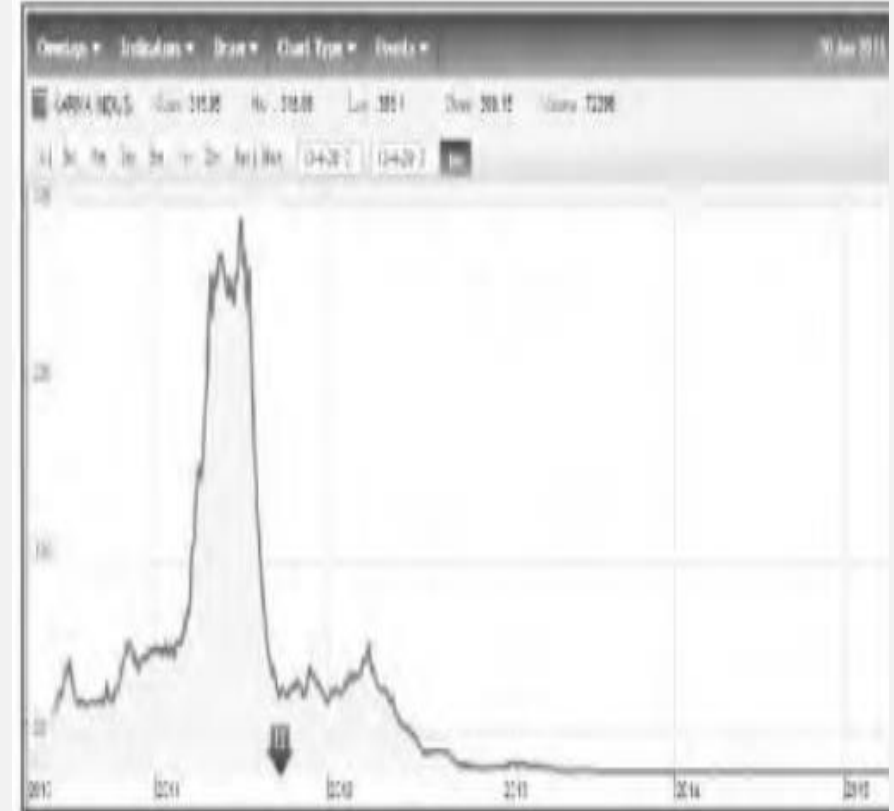
- **ASHIKA CREDIT CAPITAL LTD [Scrip ID:ASHIKACR, Scrip Code: 590122]**

It has been gathered that price of shares of this company rose from T 49 to 248.2 in just 338 trading days during the period from 2/4/2012 to 11/12/2013. i.e. nearly 5 times in 338 trading days only. The volume of trade increased 5 to 6 times during Dec, 13. This gives a clear picture that this penny stock has been for providing accommodation entry of Bogus LTCG.



- **KARMA INDUSTRIES LTD [Scrip ID: KARMA, Scrip Code: 512585]**

It has been gathered that price of shares of this company was Rs. 311 on 29/06/2011 which fallen to Rs. 48.5 on 26/09/2011 within the span of 3 months i.e. in just 50 trading days during the period. During the period between 26/09/2011 to 08/02/2012 price of scrip was moving around Rs. 50 only. Then again spurt in price was made at the feb end of financial year to Rs. 72 on 26/03/2012. Finally scrip started falling freely from Rs. 72 to Rs. 3.35 within the period of 26/03/2012 to 05/11/2012.



# PERSONS INVOLVED IN TRANSACTION



As per the report, there are three categories of individuals who are involved in the transactions

- **Syndicate member/ operators:** They are the promoters of the Penny Stock companies who own the initial shareholding mostly in the name of paper companies either in a fresh IPO or purchased from the shareholders of a dormant company.
- **Share brokers:** These are registered brokers through whom shares are traded both online and offline.
- **Entry operator / Scrip Operator:** These are individuals who control a large number of paper/shell companies known as Jama-Kharchi Entities which are used for routing cash for the transactions as well as buying and selling shares during the process of price rigging.

# TYPES OF PENNY STOCK COMPANIES

- 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.
- 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.

# METHOD OF TRANSACTION

## 1. Conventional method

- Purchase of share by the beneficiary
- Price rigging
- Final sale by the beneficiary

## 2. Merger method

- Form a Private Limited Company
- Issue shares at par to Beneficiary Individuals
- This company is then amalgamated / merged with a listed penny stock company by a High court order



# **JUDICIAL PRONOUNCEMENTS** **(IN FAVOUR OF ASSESSEE)**



# WHETHER AN OFF- MARKET PURCHASE OF SHARE CAN BE A GROUND TO DECLARE THE TRANSACTION A SHAM?

**Held: No,**

The transactions could not be treated as sham transactions although they are off-market transactions if the assessee has discharged its onus of proving the fact that shares purchased by him were dematerialized in the Demat account and are held by the assessee till the same were sold from the Demat account of the assessee. The transaction of holding shares are reflected in the Demat account and the sale of shares are also through Demat account. Also, the purchase and sale price of the shares declared by the assessee's are in conformity with the market rates prevailing on the respective dates as seen from the documents furnished by the assessee.

- ❖ **CIT vs. Smt. Jamnadevi Agrawal, [2010] 328 ITR 656, (Bombay HC)**
- ❖ **Tekchand Rambhiya HUF vs. ITO, ITA No. 960/Mum/2012, Date of Pronouncement -16/09/2015, (ITAT-Mum.)**
- ❖ **CIT vs. Shyam R. Pawar [2015] 229 Taxman 256 (Bombay)**
- ❖ **CIT v. Mahesh chandra G.Vakil 220 Taxman 166 (Gujarat)(HC)**

## WHETHER REVENUE CAN INVOKE SECTION 68 JUST BECAUSE SHARE APPLICANTS COULD NOT BE FOUND AT GIVEN ADDRESS?

### **Held: No,**

In any matter, the onus of proof is not a static one. Though in section 68 proceedings, the initial burden of proof lies on the assessee yet once he proves the identity of the creditors/share applicants by either furnishing their PAN number or Income-tax assessment number and shows the genuineness of transaction by showing money in his books either by account payee cheque or by draft or by any other mode, then the onus of proof would shift to the revenue. Just because the creditors/share applicants could not be found at the address given, it would not give the revenue the right to invoke section 68. One must not lose sight of the fact that it is the revenue which has all the power and wherewithal to trace any person. Moreover, it is settled law that the assessee need not to prove the 'source of source'.

**Dwarkadhish Investment (P.) Ltd. Vs. CIT [2010] 194 TAXMAN 43, Delhi(HC)**

# WHETHER AN ASSESSING AUTHORITY CAN REJECT THE EXPLANATION OF ASSESSEE ON THE BASIS OF PRESUMPTION?

**Held: No,**

Whatever it may be, an assessment has to be completed on the basis of records and materials available before the assessing authority. Personal knowledge and excitement on events, should not lead the Assessing Officer to a state of affairs where salient evidences are overlooked. If every transaction of the assessee has been accounted, documented and supported and even the evidences collected from the concerned parties have been ultimately turned in favour of the assessee, it would be very difficult to brush aside the contentions of the assessee.

- ❖ **Pr. CIT vs. Prem Pal Gandhi, ITA-95-2017 (O&M) Date of Decision-18.01.2018 (Punjab & Haryana HC)**
- ❖ **CIT vs. Mukesh R. Marolia, ITA No. 456 of 2007, Date of Pronouncement -07/09/2011, High court of Bombay**

**Similar decision is taken in the following cases:**

- ❖ **Meenu Goel vs. ITO, Ward-31(1), ITA No. 6235/DEL/2017, Date of pronouncement: 19.03.2018, ITAT- Delhi**
- ❖ **Nidhi Goel vs. ITO, Ward-49(4), New Delhi (ITAT, ITA No. 6882/DEL/2017) Date of Pronouncement: 12.03.2018**
- ❖ **Mohit Hora (HUF) vs. ITO, Ward-2(5), Gurgaon (ITAT, ITA No. 410/DEL/2018) Date of Pronouncement: 12.03.2018**
- ❖ **Chander Prakash vs. ITO, Ward-49(4), New Delhi (ITAT, ITA No. 6880/DEL/2017) Date of Pronouncement: 12.03.2018**

# WHETHER THE FINDINGS RECORDED BY THE ASSESSING OFFICER CAN BE BASED ON PRESUMPTIONS?

## **Held: No**

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, de-mat 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 136 to the company having been returned unserved; delayed payment to the brokers; and de-materialisation 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 absence of any cogent evidence to the contrary**

- ❖ **CIT vs. Sumitra Devi, ITA no. 54/2012, Date of Pronouncement – 24/02/2014, High Court of Rajasthan**
- ❖ **Shri Dolarrai Hemani Vs. ITO, ITA no. 19/Kol/2014, Date of Judgement: 02/12/2016, ITAT- Kolkata**

# WHETHER SUSPICION OF ASSESSING OFFICER CAN BE THE FOUNDATION OF A DECISION?

## **Held: No**

It was held by the Hon'ble ITAT that **conjecture is not a substitute for legal proof. Suspicion however strong, cannot take the place of proof.** The ITO would not be justified in deciding a case upon his own suspicion or upon mere supposition after discarding the evidence produced by the assessee. One must be careful not to carry caution to an extreme length and not to discard oral evidence merely because it is oral and unless the impeaching and discrediting circumstances are clearly found to exist. Evidence of persons even though not independent but who are not shaken in cross examination, cannot be rejected on mere suspicion when the story itself as told by them is not improbable. The general rule is that whenever it is intended to impeach the credit of a person whose statement has been recorded, his attention must be drawn to the discrediting facts so that he may have an opportunity of explaining them.

- ❖ **ITO Vs Ashok Kumar Aggarwal, [1990] 38 TTJ 189 (ITAT - Delhi)**
- ❖ **ACCHYALAL SHAW vs. INCOME TAX OFFICER, (2009) 121 TTJ (Kol) 695, ITAT, KOLKATA**

# THE ASSESSMENT CANNOT BE DONE ON THE BASIS OF CONJECTURES & SURMISES

## **Held:Yes**

The Hon'ble Supreme Court held that It is equally clear that in making the assessment under section 23(3) he is **not entitled to make a pure guess and make an assessment without reference to any evidence or any material at all and there must be something more than bare suspicion to support the assessment** under section 23(3). In the instant case, the Tribunal violated certain fundamental rules of justice in reaching its conclusions. Firstly, it did not disclose to the assessee what information had been supplied to it by the departmental representative. Next, it did not give any opportunity to the assessee to rebut the material furnished to it by him, and lastly, it declined to take all the material that the assessee wanted to produce in support of its case. The result was that the assessee had not had a fair hearing.

**Dhakeswari Cotton Mills Ltd.Vs. CIT, [1954] 26 ITR 775, Supreme Court of India**



# WHETHER SECTION 68 IS APPLICABLE MERELY ON THE BASIS OF PRESUMPTION, SURMISES AND CONJECTURES?

## **No, Held that**

The material evidence placed on record by the assessee and in the light of the discussion of the factual and legal matrix of the case, it was considered that **the AO/CIT(A) have made the addition under section 68 of the Act merely on presumptions, suspicions and surmises in respect of penny stocks disregarding the direct evidences placed on record** and furnished by the assessee in the form of brokers contract notes for purchases and sales of the shares, copies of the physical share certificates and her D-MAT account statement confirmation of the transactions of buying and selling of the shares by the respective stock brokers, receipt of sale proceeds through banking channels, etc. Since, the statement was recorded behind the assessee's back, from a person who was not involved in the purchase of the said shares would **have no evidentiary or corroborative value to be the basis for coming to an adverse view** in the case on hand. Also, the assessee was not afforded opportunity for rebuttal of the same and to cross-examine the said person.

**Ms. Farrah Marker Vs. ITO, ITA no. 3801/Mum/2011 Date of Pronouncement-27.04.2016, (ITAT - Mum.)**

**Similar decision is taken in the following cases:**

- ❖ **Shri Dolarrai Hemani vs. ITO, ITA no. 19/Kol/2014, Date of Judgement: 02/12/2016, ITAT- Kolkata**
- ❖ **DCIT vs. Sunita Khemka, ITA no. 714 to 718/Kol/2014, Date of Pronouncement–28/10/2015, ITAT- Kolkata**
- ❖ **Gopinath Naik Vs. CIT [1936] 4 ITR 1, High Court of Allahabad**
- ❖ **Smt. Sunita Jain Vs. ITO, ITA no. 501&502/AHD/2016, Date of Pronouncement – 09/03/2017, ITAT – Ahmedabad**
- ❖ **ITO Vs. Smt. Aarti Mittal, ITA No.165/Hyd/2011 Date of Decision-06.11.2013 (Hyderabad- ITAT)**

# WHETHER SECTION 68 IS APPLICABLE EVEN IF THE ASSESSEE HAS PROVIDED ALL SUPPORTED DOCUMENTS?

**Held: No,**

It is observed that even though A.O. has vast powers u/s 131 and 133 (6) of the Act, he has not used it to verify the genuineness of the claim of the assessee by verifying the documents furnished by it. If A.O. had doubted the impugned transaction after receiving the evidences which had been produced by the assessee in support of its claim it was very much open to the A.O. to do his independent enquiry and verification. This has not been done by the A.O.

Further, the assessee has proved the identity of the purchaser of the shares and has also submitted the documentary evidences in support of the transaction. It is also seen that the Assessing Officer could not point out any discrepancy in the evidences relied upon by the assessee. He has neither brought out any direct or inference evidence in contradiction of the assessee. Therefore, the transaction could not be said as fraudulent and section 68 is not applicable.

❖ **PCIT vs. Jatin Investment Pvt. Ltd., ITA no. 43/2016 & 44/2016, Date of Pronouncement -18/01/2017, High Court of Delhi**

❖ **Surya Prakash Toshniwal HUF v. ITO ITA No.1213/Kol/2016 (Kol. - ITAT)**

❖ **Order of CIT(A), Delhi - EPS Fin Vest Pvt. Ltd. Vs ITO (ITA No.420/16-17), Date: 02-05-2018**

# WHETHER AN ASSESSEE IS DEEMED TO BE INVOLVED IN NON-GENUINE TRANSACTION IF HIS BROKER WAS SUPPOSED TO VIOLATED THE REGULATIONS?

## **Held: No,**

In the present case, the purchase and sale of shares is done through some broker. And, the payment by account payee cheque has not been disputed. Also, the payment on purchase and sale and payment received by account payee cheque was on two different dates. If the share broker, even after issue of summons, does not appear, for that reason, the claim of the assessee should not be denied, specially in cases when the existence of the broker is not in dispute nor the payment is in dispute. Merely because some broker failed to appear, the assessee should not be punished for the default of a broker and we are in full agreement with the Tribunal that on mere suspicion the claim of the assessee should not be denied.

- ❖ **CIT Vs. Carbo Industrial Holdings Ltd. [2000] 244 ITR 422 (Calcutta High Court)**
- ❖ **Asstt. CIT vs. Bhavik Bharatbhai Padia [2017] 78 taxmann.com | 33(Ahmd.Tribunal)**

Nowhere the AO has alleged that the transaction by the assessee with these particular broker or share was bogus, merely because the investigation was done by SEBI against broker or his activity, **assessee cannot be said to have entered into in genuine transaction, insofar as assessee is not concerned with the activity of the broker and have no control over the same.**

- ❖ **ITO vs. Indarvadan Jain, ITA no. 4861/Mum/2014, Date of Judgment: 27/05/2016, ITAT-Mumbai**
- ❖ **ITO vs. Arvind Kumar Jain ITA No.-4862/Mum/2014 Date of Decision- 18.09.2017 (Mumbai- ITAT)**

# WHETHER AO, ON THE BASIS OF REPORT RECEIVED FROM INVESTIGATION WING CAN COME TO A CONCLUSION?

**No,**

Held that having heard rival submissions, we are of the view that the order passed by Ld CIT(A) does not call for any interference. We notice that the AO has simply placed reliance on the report given by the investigation wing of the department without conducting any independent verification of the matter. More particularly the evidences furnished by the assessee to support the purchase and sale of shares have not been proved to be bogus in nature. Therefore, the appeal filed by the revenue is dismissed.

- ❖ **ITO V. Smt. Hansaben N. Shah, I.T.A. No. 44/Mum/2016, Date of Pronouncement: 19-10-2016, ITAT Mumbai**
- ❖ **PCIT Vs. Laxman Industrial Resources Ltd., ITA no. 169/2017, Date of Order – 14/03/2017, Delhi HC**
- ❖ **Arvind Mehta vs. ITO, ITA No. 2799/Mum/2015 Date of pronouncement: 29-2-2016**

## WHETHER AO CAN RELY ON THIRD PARTY STATEMENT WITHOUT PROVIDING CROSS EXAMINATION?

**Incorrect,** Held that we find that the A.O had rather chosen to merely rely on the stand alone statement of third party and taking the same as gospel truth, had therein drawn adverse inferences in the hands of the assessee by merely referring to the said statement. The failure on the part of the A.O to provide cross examination of the person, relying on whose statement adverse inferences are drawn in the hands of the assessee goes to the very root of the validity of such adverse inferences drawn in the hands of the assessee, We thus in the backdrop of the totality of the facts of the case are unable to find ourselves to be in agreement with the view arrived at by the lower authorities. The appeal of the assessee is allowed.

❖ **Kamla Devi S. Doshi Vs. ITO, I.T.A. No. 1957/Mum/2015, Date of Pronouncement: 22-05-2017, ITAT Mumbai**

**Similar decision is taken in the following cases:**

- ❖ **Shri Sunil Prakash Vs. ACIT, ITA no. 6494/Mum/2016, Date of Pronouncement – 08/03/2017, ITAT-Mumbai**
- ❖ **CIT vs. M/s Ashish International (ITA No 4299 of 2009) Date of Pronouncement - 22.02.2011**
- ❖ **Dhirajlal Girdharilal vs. CIT (1954) 26 ITR 736 (SC)**
- ❖ **Sudhanshu Suresh Pandhare v. ITO I.T.A. No. 5185/Mum/2012 (Mum.-ITAT) Date of Pronouncement – 05.10.2016**



# WHETHER ORDER PASSED BY AO WITHOUT PROVIDING REASONABLE OPPORTUNITY TO ASSESSEE IS GOOD IN LAW?

**Held : NO**

That the assessee could have placed evidence before the first appellate authority or before the Tribunal is really of no consequence for it is the assessment order that counts. That order must be made after the assessee has been given a reasonable opportunity of setting out his case. It was not necessary to set aside the order of assessment and remand the matter to the assessing authority for fresh assessment after giving to the assessee a proper opportunity of being heard.

**Tin Box Co.V. CIT [2001] 249 ITR 216, Supreme Court of India**

WHETHER DENIAL TO THE ASSESSEE OF THE RIGHT TO CROSS-EXAMINE THE WITNESS WHOSE STATEMENT WAS MADE THE BASIS OF THE IMPUGNED ORDER RENDERS THE ORDER A NULLITY?

**Held:Yes**

The Hon'ble Supreme Court held that we are of the opinion that if the testimony of the witnesses is discredited, there was no material with the Department on the basis of which it could justify its action, as the statement of the aforesaid witnesses was the only basis of issuing the Show Cause. We, thus, set aside the impugned order as passed by the Tribunal.

**Andaman Timber Industries vs. CCE (2015), Civil Appeal No. 4228 of 2006, Date of Pronouncement: 02.09.2015, Supreme Court of India**

# JUDICIAL PRONOUNCEMENTS (AGAINST ASSESSEE)



ASSEESSEE'S CLAIM IS REJECTED IF PURCHASE TRANSACTION IS NOT RECORDED IN STOCK EXCHANGE AND SELLING RATES ARE HIKED ARTIFICIALLY WITH NO REAL BUYERS.

**Held that** it was noted that the purchase of shares was off market purchase not reported in the stock exchange. Moreover, the purchase was through a back date contract note in cash and, there was no trial. It was also noted that the shares belonged to a penny stock company, with no credentials, and selling rates were artificially hiked, with no real buyers. On facts, inference of sales being bogus was unmistakable and, consequently, impugned addition was to be confirmed.

- ❖ **ITO v. Shamim M. Bharwani [2016] 69 taxmann.com 65 (Mumbai - Trib.)**
- ❖ **Ritu Sanjay Mantry vs. ITO, I.T.A. No. 2003/Mum/2017, Date of Pronouncement: 09.02.2018 (Mumbai - Trib.)**

## LTCG ON SALE OF SHARES IS DEEMED TO BE UNDISCLOSED INCOME WHEN ASSESSEE FAILED TO PROVIDE ANY EXPLANATION REGARDING THE PURCHASE AND SALE OF SHARES?

**Held**, that where assessee had purchased shares of penny stock companies at lesser amount and sold such shares within a year at much higher amount and assessee had not given any cogent evidence to explain as to how the shares in an unknown company worth such less value had jumped to much higher amount in no time and also failed to provide details of person to whom he has sold such shares. Such transactions were attempt to hedge undisclosed income as Long term Capital gain. It was held that the motive of the investment is earn profit not to derive income. It is a clear finding of fact that the assessee had indulged in a dubious share transaction meant to account for the undisclosed income in the garb of long term capital gain.

- ❖ **Sanjay Bimalchand Jain v. Pr. CIT [2018] 89 taxmann.com 196 (Bombay) (HC)**
- ❖ **ACIT vs. Arvind M. Kariya, ITA No. 5670/Mum/2008, Date of Pronouncement – 09/06/2008, ITAT - Mumbai**

# WHETHER ASSESSING OFFICER CAN PASS THE ORDER BY APPLYING THE TEST OF HUMAN PROBABILITIES?

**Yes.**

**Held,** that assessee could not produce the copies of share certificates and copies of share transfer forms. The assessee could not furnish any reasons or at-least stock market news to support the abnormal increase in the prices of the above said shares. The financial statements of the above said company were also not produced. The transaction of purchase of shares could not be cross verified. The shares were declared as “Penny Stock” by SEBI and the broker through whom the shares were sold by the assessee was indicted for manipulating the prices of penny stock shares.

**Usha Chandresh Shah vs. ITO, /IT A No. 6858/ Mum/ 2011, ITAT - Mumbai**

# STEPS TAKEN BY THE GOVERNMENT



## AMENDMENT IN SECTION 10(38)

- Earlier, LTCG was made exempt by introduction of section 10(38).
- By the **Finance Act, 2017 w.e.f. 01.04.2018**, section 10(38) is amended and it is provided that:

“exemption under this section for income arising from the transfer of a long-term capital asset, being equity share acquired or on after 1st day of October, 2004 shall be available **only if the acquisition of share is chargeable to Securities Transactions Tax** under Chapter VII of the Finance (No 2) Act, 2004.”
- Further, the aforesaid section is **removed** by the **Finance Act, 2018 w.e.f. 01.04.2019** and a new section is inserted i.e. **section 112A** which provides:

“tax capital gain on transfer of long term capital asset being equity shares of a company or unit of MF or unit of business asset, where STT has been paid, exceeding **Rs.1 lac** at the rate of 10% .”



## RATE OF TAX : SEC 115BBE

- Section 115BBE was inserted by The Finance Act 2012 w.e.f. 1.4.2013.
- Income chargeable under sections 68, 69, 69A, 69B, 69C or 69D, the income would be chargeable @ 60%. Surcharge will also be paid @ 25%.
- No deduction shall be allowed to the assessee in respect of any expenditure or allowance or set off of any loss under any provision of the Act in computing the income u/s 68, 69, 69A, 69B, 69C or 69D whether the same has been disclosed in the return of income or not.
- **Earlier i.e. before 01-04-17, the rate of tax payable on such income was 30%.**
- **The purpose of amendment is to strict the regime of tax & penalty and to reduce the tax evasion.**

# SOP ISSUED BY THE DEPARTMENT

- To Ensure that the no tax evaders are left out on procedural and technical grounds, the department has prepared Standard operating procedures (SOPs) to be adopted by the Assessing officers while framing assessment orders in penny stock cases.
- Not only the procedures are standardized, but the specific formats were given for the following;
  - Draft questions for statement to be recorded u/s 131
  - Draft Show cause notices
  - Draft assessment orders
  - Draft of reasons recorded u/s 148
- Further a draft order noting is given in following situations
  - If a request is made for cross examination
  - If deponent files affidavit retracting statements, etc.

# PENALTY & PROSECUTION

## Penalty u/s section 271AAC (Inserted by Finance Act, 2016, w.e.f. 1.4.2017):

- Provides for a penalty of 10% of the tax payable under section 115BBE.
- No penalty would be leviable to the extent such income has been included by the assessee in the return of income furnished u/s 139 and the tax in accordance with the provisions of section 115BBE(1)(i) has been paid on or before the end of the relevant previous year.

## Penalty u/s section 270A (Inserted By Act No. 8 of 2016 (w.e.f. 01.04-.2017):

- Leviable in case of under reporting and misreporting of income.
- Penalty levied will be **50%** of the tax payable on **under reported income** and **200%** of the tax payable on **misreporting of income**.
- **Before this, penalty u/s section 271(1)(c) was applicable as under:** Leviable in case of concealment of income or furnishing of inaccurate particulars. Penalty levied may range from 100% to 300% of the amount of tax evaded. See, ***Shanti Ramanand Sagar v. [2017] 88 taxmann.com 72 (Bombay)***

**Penalty u/s 27 I AAB** (In case, additions have been made pursuant to a search action u/s 132):

The section provides as follows:

<b>NATURE OF DEFAULT</b>	<b>AMOUNT OF PENALTY</b>
Admission in the course of search of undisclosed income of the specified previous year in a statement u/s 132(4)	<b>10%</b> of undisclosed income of the specified previous year
Undisclosed income not admitted in a statement u/s 132(4) but declared in the return of income furnished for the specified year	<b>20%</b> of undisclosed income of the specified previous year
Any other case	<b>60%</b> of undisclosed income of the specified previous year

## Prosecution u/s 276C:

In addition to penalty, prosecution also applies in the following cases u/s 276C:

<b>Situation</b>	<b>Amount of Penalty</b>
a person wilfully attempts in any manner whatsoever to evade any tax, penalty or interest chargeable or imposable, or under reports his income,	If amount evaded or tax on under-reported income exceeds Rs. 25,00,000: <b><i>Imprisonment: 6 months – 7 years</i></b> <b><i>Fine</i></b>
	Any other case: <b><i>Imprisonment: 3 months – 2 years</i></b> <b><i>Fine</i></b>
a person wilfully attempts in any manner whatsoever to evade the payment of any tax, penalty or interest	<b><i>Imprisonment: 3 months – 2 years</i></b> <b><i>Fine</i></b>

# ASSESSMENT UNDER INCOME TAX ACT

## TYPE OF ASSESSMENT UNDER INCOME TAX ACT

- Scrutiny / Limited Assessment u/s 143(3)**
- Best Judgment Assessment u/s 144**
- Assessment/ Reassessment u/s 147**
- Search Assessment u/s 153A / 153C**



## POINTS TO BE CONSIDERED DURING ASSESSMENT PROCEEDINGS

- Check Notice(s) and appear on all dates as required.
- Explain and submit all the relevant documents which needs to be relied upon
- Ask for 'Reason to believe after filing return, if notice is received u/s 148 of the Act and object if required.
- Also, ask for the basis of his suspicion and check whether the AO has applied his rational mind and independently arrived at a belief.
- Ask for cross-examination of the third party whose statement is recorded / relied by the AO.
- Check whether assessee's name is specifically mentioned in the statement recorded/ report utilised by the AO against the assessee.
- Ask for the information used by the AO for cross-examination/ rebuttal.
- Ask for reasonable opportunity of being heard, if not provided.

## ISSUES NEED CLARIFICATION

- Whether the sale considerations of such penny stock be treated as cash credits u/s 68.
- Whether basic principles of cash credit u/s 68 i.e. identity, creditworthiness, genuineness apply for share transactions undertaken at recognized stock exchange. As there is no privity of contract between the buyer and seller while making transactions at stock exchange.
- Whether all share transactions of the company be treated as non-genuine, merely because investigation was conducted on that company or may be identified as penny stock in the report?
- Whether share transaction be treated as bogus, where SEBI has passed its interim order against the company/ promoters of the company, despite the fact that on completion of the investigation, SEBI did not find any adverse evidence/ findings amounting any violation in respect of many entities.
- Whether the transactions have to be looked at holistically including all beneficiaries, operators, etc or it is necessary to conduct inquiries individually and prove the cash trails for each and every case.

**THANK YOU**

**Presented by: CA. Sanjay K. Agarwal**

**Email: [agarwal.s.ca@gmail.com](mailto:agarwal.s.ca@gmail.com)**