Office of The Commissioner Of Income Tax : Kolkata - :Kolkata

Aayakar Bhawan. Floor, P-7. Chowringhee Square, Kolkata - 700 069

1	Name of assessee	
2	Address	
3	PAN	
4	Status	Company
5	Assessment Year	2008-09
6	Date of Order	
7	Section and sub-section under which the assessment is made	u/s. 143(3)/l 47 of the Income Tax Act, 1961
8	Designation of the A.O.	
9	Name of Authorized Representative	

Order u/s. 263 of the Income Tax Act, 1961

Background: Before going into the merits of the instant case, it is necessary to highlight the background which led to it, so that the facts are viewed in correct perspective. Firstly, this particular case should not be viewed in isolation. In fact, on identical facts and under similar circumstances ,in a very large number of cases ,orders under section 148 of the IT Act were passed under different corporate CsIT charges in Kolkata. In all these cases, completed assessments were re-opened at the request of the assessee. The assesses offered paltry amounts as income which had escaped assessment and requested the A.O to tax it by passing order under section 148 of the IT Act. However, manifestly the real motive was not the sudden awakening of the fiscal honesty of the assesses, but to get the stamp of scrutiny on the huge amount of share capital and share premium which all these assesses have brought in the books. Unfortunately, the Assessing Officers seems to have missed the wood for the trees. It is pertinent to mention here that in all these cases huge amount of share capital and surprisingly, unbelievably high amount of share premium have come in the books. It does not stand the test of reasoning and defies all principles of preponderance of probability that an unknown private limited company which apparently does nothing, sells its share of Rs……./- at a premium in the range of Rs……../- to Rs. ……../. Anybody who has even a rudimentary knowledge of Capital

Market knows that even blue chip companies do not command such premium on the bourse. It is also very intriguing that so many assesses (nearly 250 odd in my charges) all with huge share capital/premium whose assessments were accepted summarily u/s 143(1) of the IT Act, suddenly realized that petty amounts had escaped assessments and all of them file request for re-opening the assessment within a short span of time. All these circumstances clearly indicate that what is apparent is probably not real and it need further examination. The Apex Court in the case of Sumati Dayal -vs.- CIT [214 ITR 801] held that the true nature of a transaction has to be ascertained in the light of surrounding circumstances. Thus, it is now well settled that tax authorities are entitled to look into surrounding' circumstances to find out the reality of a transaction, by applying the test of human probability. This order under section 263 in this case and in many other similar cases should be viewed in this background so that the larger picture is not lost in the nitty gritty of the individual case.

Modus Operandi : "There cannot be two opinions on the aspect that the pernicious practice of conversion of unaccounted money through the masquerade or channel of investment in the share capital of a company must be firmly excoriated by the Revenue."

The aforementioned quote is the observation of Hon'ble justice B N, Kripal while delivering the judgement in the case of CIT vs. Divine Leasing 299 ITR 268 Delhi The pernicious practice referred to by Justice Kripal, of late has acquired such enormous proportion that effort for excoriation is found wanting. There has been a mushrooming growth of professional entry operators who Providesuch share capital for a commission. The commission ranges from 2% to 10% of the capital given.' Kolkata rates are reported to be cheapest in the country which is why a major portion of black money from throughout the country ,s routed via the paper companies of the Kolkata entry operators and are shown as genuine share capital in the beneficiary companies. These entry operators register a large number of companies with the ROC with their employees or acquaintances as directors. There are professional directors who are willing to sign as director for a fee These companies then issue nominal share capital with huge premium The huge share premium is just to save on the fees charged by the ROC. The shares are subscribed by the own companies of the operator. The capital of the companies are raised artificially by circular transaction. For example, if one cheque of ……..is rotated through a bank account 10 times it raises the capital to …….. If there are 100 companies operated by the entry operator the total artificial capital would be Rs. …….. The balance sheet of such companies would typically show share capital and reserve (premium) on the liability side and fictitious assets like investment in unquoted shares on the asset side The investments are also in the shares of the own companies of the operator. Once this basic ground work is over, the operator is ready to give entries. Anyone can approach with cash ,which is deposited in a proprietorship account and then transferred through cheque to one of the companies of the operator After that the cheque is routed through a maze of own companies and finally given as share capital by cheque to the beneficiary company. This is a typical one time entry transaction. Alternatively, the beneficiary can buy a company in which case, the share holders change, the fictitious investments liquidated by cash provided by the buyer. The Bank account of the company has proceeds from the liquidation of investments, which the buyer uses white money without payment of tax.

The commission to be paid to be operator in respect of his companies. The rate of a company in which scrutiny assessment has been done is higher than a company where the return has been merely accepted. Similarly, commission is higher for entry from a company in which order under section 148 has been passed.

Facts of the case

In the instant case the return of income was filed on ……. declaring total income of The company's balance sheet shows share capital of Rs. …….. and Reserve (Share premium) of Rs. …….. Subsequently, the assessee filed a letter before the A.O. stating that the refund had not been received.

The Assessing Officer, on receipt of this letter, examined the balance sheet of the assessee company and found that preliminary expenses of Rs. ……./- and accounting charges of Rs……./- which were disallowable had not been disallowed. The A.O. therefore issued notice u/s.148 and subsequently, passed order u/s.147/143(3) on …… determining the total income at Rs……../-.

In view of the background mentioned at the beginning of this order a show-cause notice u/s.263 of the Act was issued vide letter dated ……. The assessee was asked to show cause as to why the impugned under section u/s 148 not be revised u/s 263 of the IT Act,1961 in view of the fact that requisite and proper inquiries were not conducted regarding the identity and creditworthiness of the shareholders and the impugned order was passed mechanically without application of mind which rendered the assessment order erroneous and prejudicial to the interest of revenue.

The assessee filed a written submission on …….. The gist of the written

submission made by the asseessee is as follows:

i) that the assessee had voluntarily offered income for tax and that the A.O. had passed the order after applying his mind.

ii) that the A.O. had conducted proper inquiry regarding the identity and creditworthiness of the shareholders. Confirmation letters along with PAN, copy of bank statement & Balance Sheet of the subscribing companies had been filed before the A.O.

iii) That share capital could not be added under section 68 of the I T Act where the identity of the share holder was established.

Reliance was placed on several authorities in support of the submissions which are dealt with later in this order.

It was accordingly, requested that in view of the aforementioned submissions, the

proceeding u/s.263 should be dropped.

I have considered the submissions of the assessee and the facts on record. As regards the submission of the assessee regarding voluntary offer of income is concerned, there is no

dispute. It is a fact that the assessee had offered a paltry amount voluntarily to tax but this fact is not relevant to the .issue under consideration, which is, whether or not the impugned assessment order under section 148 of the I T Act is erroneous and prejudicial to the interest of the revenue ,which is discussed in detail later in this order.

In so far as the claim of conducting proper inquiry by the Assessing Officer is concerned, it is worthwhile to mention that

1) the notices u/s.133(6) have been sent on only on a test check basis.
2) it is further seen that only that extract of the bank statement has been submitted which reflects only the impugned transaction and is not for the whole year, making it impossible to make any analysis of the source of the funds and whether shareholders had the financial capability to invest such substantial amounts. The A.O. should have called for the bank statement of the full financial year for proper analysis & verification.
3) the replies were just placed on record and no independent inquiries were carried out regarding the fact whether the subscribing companies were available at the given address, and whether they were genuine corporate entities.
4) The A.O. did not examine any Director of the assessee company or of the subscribing companies.

It is pertinent to mention here that mere verification by sending letters by post has no meaning in such cases of paper companies floated by entry operators. The letters for hundreds of companies are collected from just one desk at one address: Only when actual physical verification is done that it can be found out whether or not the company exists only on paper. No such exercise has been carried in this case and merely the replies which are often sent by the assessee itself has been accepted on the face value. This vital aspect has been examined rather superficially and the enquiry done therefore, amounts to actually no enquiry in real terms and is a mere formality carried out.

It is thus clear that no enquiry worth the name has been conducted in this case even though the surrounding circumstances called for in-depth enquiry of share capital. The submission of the assessee that proper enquiry had been conducted by
the A.O is therefore, factually wrong and misleading.

It is a settled position of law even before the amendment to section 56(2) to the IT Act,being effective only from Asstt .Year 2013-14, the genuineness of share capital in a private limited company could be examined in the course of , assessment and if found to be not genuine, could be taxed under the deeming provision of section 68 of the I T Act. It is also trite law that the A.O is duty bound to examine the genuineness share holding and if he fails to do so it would render the assessment order erroneous and prejudicial to the interest of revenue. In this connection reliance is placed on following authorities:

i) Rampyari Devi Saraogi vs. CIT 67 ITR 84 (SC)
ii) Tara Devi Agarwal vs CIT 88 ITR 323 (SC)
iii) Gee Vee Enterprises vs Addl.CIT 99 ITR 375,386 (Del)

iv) CIT vs. Sophia Finance Ltd. 205 ITR 98 (Del)
v) CIT vs. Active Traders P Ltd. 214 ITR 583 (Cal)
vi) CIT vs. Nivedan Vanijya Niyojan Ltd. 263 ITR 623 (Cal)
vii) CIT vs Bhagwati Jewels Ltd. 201 ITR 461 (Del)

The broad principles emerging out of the above cases can be summed up as under:-

ii) The Assessing Officer has the powers to investigate the identity of the share holders to satisfy that they exist.
ii) The genuineness of the investment has to be examined to the extent that the shareholders have invested the money. The corporate veil can be lifted and the argument that the shareholders and corporate are two different legal entities can no longer hold good. If the assessee wished to convert his unaccounted money in the form of share capital the court will not remain silent. This view has been further re-iterated in the rcent dicision of the Delhi High Cout in the case of CIT vs. Nova Promoters & Finlease Pvt. Ltd. [342 ITR 169]

As regards the reliance placed by the assessee on various authorities, only the decision of the Supreme Court in the case of Lovely Exports Pvt. Ltd 216 CTR 195 needs consideration. Other cases merely follow this decision. Even the decision in the case of Lovely Exports Pvt Ltd.(Supra) does not help the cause of the assessee as in that case the Supreme court was not concerned with the question whether or not jurisdiction u/s 263 would lie in the facts and circumstances of the instant case. The relevance of the decision in Lovely Exports Pvt Ltd.(Supra) would arise only when the AO is giving effect to this order u/s 263. Here, it suffices to mention that the applicability of the decision of the Supreme Court in Lovely Export is not universal and is to be understood and appreciated in the background of the facts of that case. In this connection ,reliance is placed on the decision of the Delhi High Court in the case of CIT vs. Nova Promoters & Finlease Pvt. Ltd. [342 ITR 169]

In this case reliance has been placed on the decision in CIT v. Stellar Investment Ltd. (1991) 192 ITR 287 (Del) cited by Mr. Pal is no longer a good law in view of the decision in CIT v. Sophia Finance Ltd. (1994) 205 ITR 98 (Del) (FB). But Mr. Pal contended that Sophia Finance Ltd.s case (supra) is no more a good law since Stellar Investment Ltd.s case (supra) was affirmed by the Apex Court in CIT v. Stellar Investment Ltd. (2001) 251 ITR 263 (SC). But this view does not seem to be correct. In Stella - Investment Ltd.s case (supra), the Apex Court had passed the following order :

> "We have read the question which the High Court answered against the revenue. We are in agreement with the High Court. Plainly, the Tribunal came to a conclusion on facts and no interference is called for. The appeal is dismissed. No order as to costs."

From the above observation, it appears that the Supreme Court has not entered into the question involved or has not decided the ratio laid down. It had plainly held that it was a question of fact. The Supreme Court has not laid down any proposition with regard to the question. It was purely a question of fact with which the Apex Court had dealt with and was in

agreement with the High Court on conclusion of facts. Therefore, it cannot be said that the Supreme Court answered the ratio laid down as sought to be propounded by the Delhi High Court in Stellar Investment Ltd.s case (supra). A decision becomes binding as a precedent only when the court decides a particular question of law or lays down the ratio through conscious adjudication. Agreement with the finding of fact without adverting to the ratio laid down does not create a precedent. In order to support this view, we may refer to the decisions in Municipal Corpn. of Delhi v. Gurnam Kaur AIR 1989 SC 38; Gangadharan v. Janardhana Mallan AIR 1996 SC 217 and Director of Settlement v. M.R. Appa Rao 2002 (4) SCC 638. We are, therefore, unable to agree with the contention of Mr. Pal that the decision in Sophia Finance Ltd.s case (supra) is no longer a good law.

The only issue relevant for consideration in the instant case is whether or not the impugned order u/s 148 IT Act is erroneous and prejudicial to the interests of Revenue in the context of section 263 of the IT Act.

In this connection, the observation the Delhi High Court in the case of Gee Vee Enterprises vs Addl.CIT 99 ITR 375,386 (Del) quoted below is of particular relevance.

'intention of the legislature was to give a wide power to the Commissioner. He may consider the order of the Income-tax Officer as erroneous not only because it contains some apparent error of reasoning or of law or of fact on the face of it but also because it is a stereo-typed order which simply accepts what the assessee has stated in his return and fails to make inquiries which are called for in the circumstances of the case. The AO is both an adjudicator as well as an investigator, and it is his duty to ascertain the truth of the facts stated in the return if such an exercise is [1]provoked', or becomes 'prudent'. Section 263 which deals with the Revision of orders prejudicial to the revenue by the Commissioner comes into operation wherever the AO fails to make such an inquiry because it renders the order of the AO "erroneous." It seems to us that if this duty pervades the normal functioning of the AO, it becomes acute and essential in the special circumstances surrounding Section 68 of the IT Act."(Emphasis supplied)

Attention is further invited to the observation of the Kerala High Court in Bismillah. Trading Co.Vs Intelligence Officer 248 ITR 292 , reproduced below

"In our opinion the word "prejudice" must be judicially examined. What constitutes "prejudice to the Revenue" has been the subject-matter of a judicial debate. One view was that "prejudicial to the interests of the Revenue" does not necessarily mean loss of revenue. The expression "prejudicial to the interests of the Revenue" is not to be construed in a petti-fogging manner, but must be given a dignified construction. The interests of the Revenue are not to be

equated to rupees and paise merely. There must be some grievous error in the order passed by the Income-tax Officer which might set a bad trend or pattern for similar assessments which, on a broad reckoning, the Commissioner might think to be prejudicial to the Revenue administration. The prejudice must be prejudice to the Revenue administration, "(emphasis supplied)

As has been pointed out in the beginning of this order, under the heading 'background', the case of the assessee is not to be viewed in isolation. The fact that under similar circumstances, similar order u/s 148 have been passed in nearly 250 odd cases in my charge of CIT- II alone ,also should not be lost sight of. I am given to understand that in other corporate CIT charges in Kolkata also, similar orders in bulk have been passed. The A.O seems to have missed the larger picture and unwittingly has ended up giving a certificate of genuineness of share capital by passing the impugned order. This by itself establishes that such orders are erroneous and prejudicial to the interests of the Revenue administration, as observed by the Kerala High Court in the decision quoted above.

In view of the special facts and circumstances as well as the judicial decision relied upon, the impugned order u/sl48 is therefore, set aside u/s 263 of the IT Act and the A.O. is directed to

i) Examine the genuineness and source of share capital, not on a test check . basis, but in respect of each and every shareholder by conducting independent enquiry not through the assessee. The bank account for the entire period should be examined in the course of verification to find out the money trail of the share capital

ii) Further the A.O. should examine the directors as well as examine the circumstances which necessitated the change in directorship if applicable. He should examine them on oath to verify their credentials as director and reach a logical conclusion regarding the controlling interest.

iii) The A.O. is directed examine the source of realization from the liquidation of assets shown in the balance sheet after the change of Directors ,if any

After conducting the inquiries & verification as directed above, the A.O. should pass a speaking order, providing adequate opportunity of being heard to the assessee.

The impugned order u/s 148 is accordingly set aside and assessment should be done afresh.

(KAVITA JHA)

Commissioner of Income Tax
Kolkata-ll. Kolkata