



RECENT DEVELOPMENTS IN TAXATION OF TRANSACTIONS OF PENNY STOCKS

*O/o CIT(Judicial), Ahmedabad
Pr. Chief Commissioner of Income Tax, Gujarat*





PENNY STOCK IN GENERAL

- **Word ‘Penny’ is derived from U.S. Currency and is generally used for Stocks which trade at low prices and have extremely low market capitalization. Shares priced below Rs. 10 are commonly known as Penny Stocks.**
- **There is difference between Penny Stock and Penny Business. Penny Stocks need not mean Penny Business.**

CHARACTERISTICS OF PENNY STOCKS

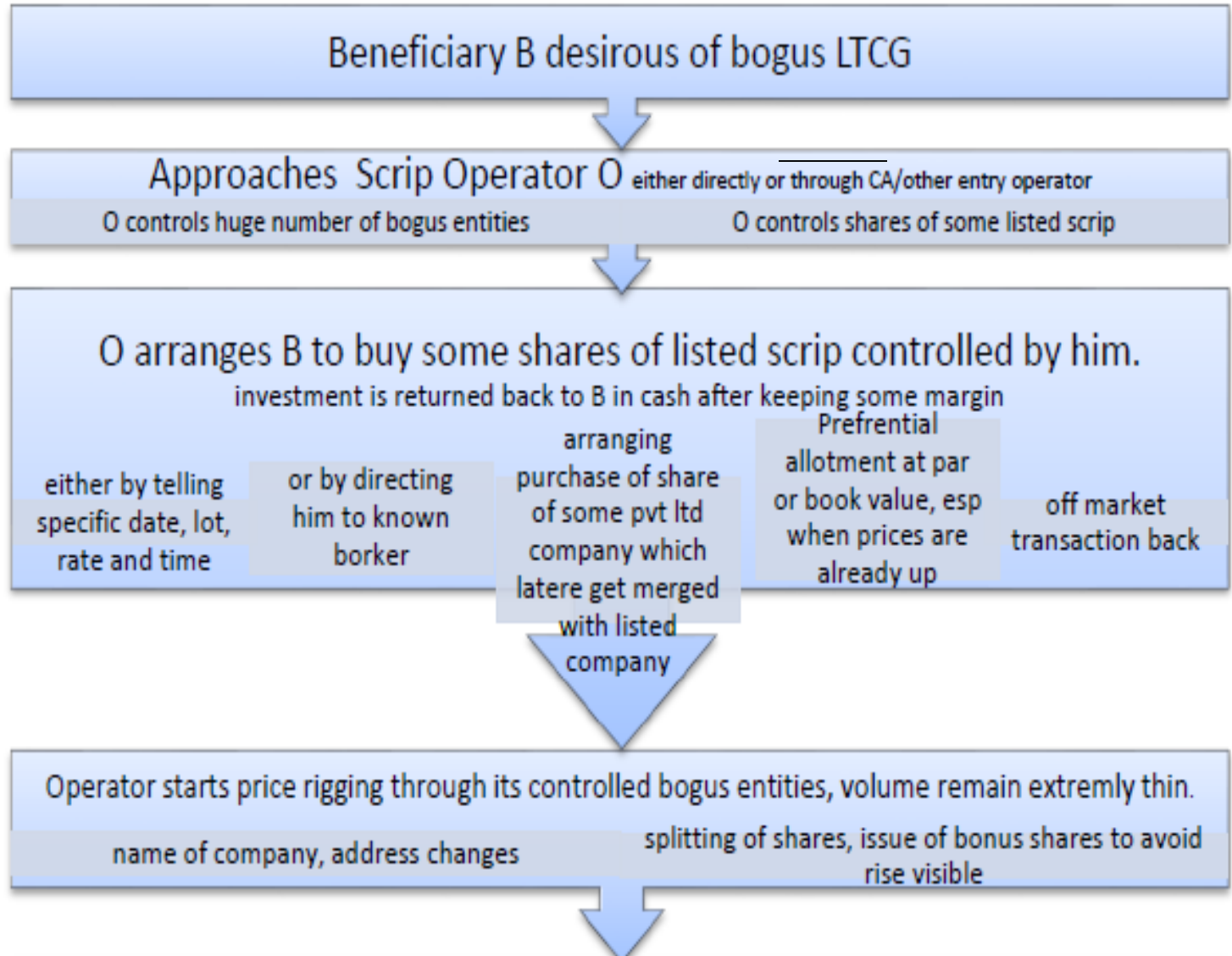
- **Low market capitalization**
- **No core underlying business/assets**
- **No Core financials / business fundamentals**
- **No institutional holdings**
- **Poor Corporate governance/irregular filings**
- **Illiquid and infrequently traded**
- **Low prices but extremely high valuations**

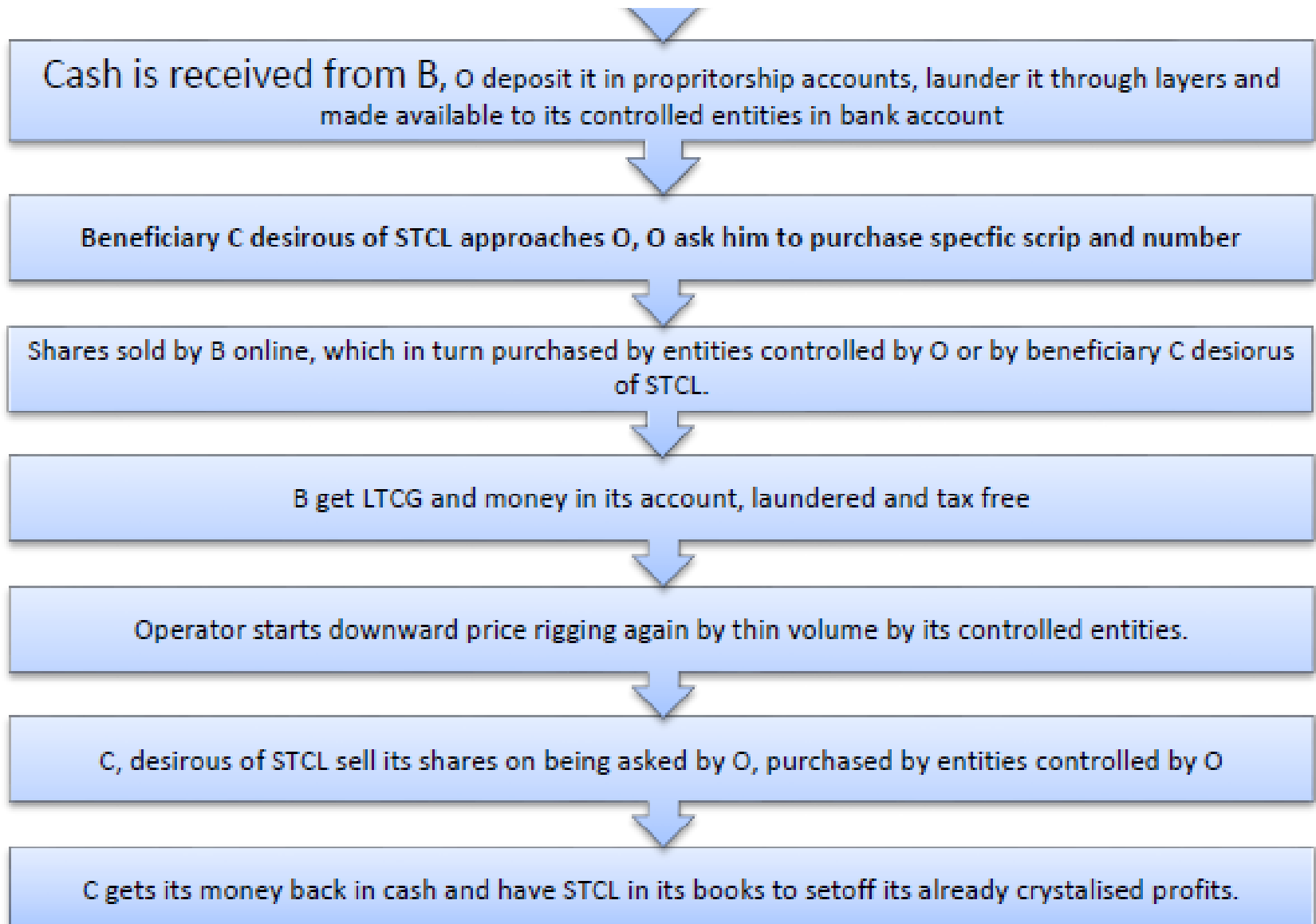


MODUS OPERANDI FOR GENERATING BOGUS LTCG AS PER THE REVENUE DEPARTMENT

- **Investigation carried out by the Investigation Wing of Income Tax, Mumbai.**
- **Investigation carried out by the Investigation Wing of Income Tax, Kolkata.**

Modus Operandi as reported by the Investigation Wing:





Types/routes of LTCG/STCG in Penny stocks

- Purchase of equity shares usually off-market, in cash & in physical form. Shares converted into demat belatedly, usually just before sale.
- Allotment of preference shares, usually off-market, in cash & in physical form. Shares converted into demat belatedly, usually just before sale.
- Allotment of bonus shares after splitting up, usually to camouflage unusual & exponential rise in price of penny stock.

ACTIONS OF SEBI

- **SEBI, from time to time investigates the affairs of brokers and companies and detects manipulation and price rigging by the market participants under PFUTP (Prohibition of Fraudulent and Unfair Trade Practices Regulations).**
- **SEBI has, in the past, barred several entities where nexus between promoters, allottees of Equity Shares, exit providers and LTP (Last Traded Price) contributors is found.**
- **News articles show that SEBI acted upon or is contemplating action on various entities based on the report of the Investigation Wing of the Revenue Department suggesting manipulation the Stock Exchange market platform for evasion of tax by generating bogus LTCG.**

ACTIONS OF SEBI (Contd...)

- The order of the Hon'ble Supreme Court in the case of **SEBI Vs. Rakhi Trading Pvt. Ltd. & Ors. dated 08.02.2018** and observations therein.

The Hon'ble SC, refrained from any observations and findings with regard to manipulation of the Stock Market for achieving motives of tax planning and tax evasion as the same was not the issue in adjudication proceedings.

However, the Hon'ble SC in the context of another case of Viram Investment has kept it open.

SEC. 10(38) - RECENT AMENDMENTS

- **Income arising from transfer of long term capital asset being Equity Shares in a Company or to be exempt where -**
 - i) Transaction of sale of Equity Shares is entered after the date on which provisions of levy of STT came into force (i.e. 1st October 2004), and**
 - ii) Such transaction is liable to STT.**

SEC. 10(38) - RECENT AMENDMENTS (contd..)

- **Vide Finance Act 2017, w.e.f. 01.04.2018, where transaction of acquisition of Equity Shares being long term capital asset entered into on or after 01.10.2004 which is not chargeable to STT (except the acquisition notified) shall not be regarded as transaction u/s. 10(38).**
- **The acquisitions excepted are notified by Notification No. SO 1789(E), dated 05.06.2017.**

SEC. 10(38) - RECENT AMENDMENTS (contd..)

- **By the Finance Act, 2018, the exemption u/s. 10(38) is withdrawn and such transactions are to be taxed in accordance with Sec. 112A. (Circular dated 04.02.2018 in the form of FAQs).**
- **Issue for consideration**
 - **Taxability of transactions of Long Term Equity Shares where the purchase and sale is completed before 31.03.2017.**

HEAD OF INCOME

- In majority of the cases, it is seen that income is assessed u/s. 68 and in very few cases u/s. 69A.
- In some cases, the income is also assessed as business income considering it as in the nature of adventure or trade.
- See relevance of the Head of income from the perspective of rate of tax, set off of losses, etc.

SECTION 115BBE

- **Inserted by the Finance Act 2012 w.e.f. 01.04.2013 to provide for taxation of income under Sec. 68 to Sec. 69D @ 30% upto A.Y. 2016-17 and 60% from A.Y. 2017-18 whether offered in the return of income or assessed by the AO.**
- **No deduction, expenditure or allowance to be allowed against such income as -**
 - **Finance Act 2016 from 01.04.2017 prohibits set off of any loss against income u/s. 68 to 69D in computing the income offered in the return furnished u/s. 139.**

SECTION 115BBE (contd...)

- Finance Act 2018 has made further amendment w.r.e. from 01.04.2017 prohibiting the set off of loss also against the income assessed u/s. 68 to 69D.
- Assessing Officers are applying the above provisions from the A.Y. 2013-14 itself and interpreting such provisions to be retrospective.
- **This issue has been settled by CBDT circular no. 11/2019 dated 19/06/2019 wherein the assessee has been allowed set-off of losses till AY 2016-17.**

PENALTY U/S. 271AAC (Inserted from A.Y. 2017-18)

- **Where income determined includes income referred to in Sec. 68 to 69D, the penalty payable shall be 10% of the tax payable u/s. 115BBE.**
- **No penalty shall be levied where such income is included in the return furnished u/s. 139 and the tax in accordance with provisions of clause 115BBE(1)(i) is paid **on or before the relevant previous year.****

PENALTY U/S. 271AAC [Inserted from A.Y. 2017-18] (contd...)

- **Issues for Consideration:**
 - **For subjecting the income to tax u/s. 115BBE and penalty u/s. 271AAC, would it be necessary that the income is to be specifically assessed by applying the provisions of Sec. 68 to 69D?**
 - **In a case where the AO discusses in the order the taxability of the amount as income from unexplained sources, however, assesses the same as income from other sources, would the position be different?**

PENALTY U/S. 271AAC [Inserted from A.Y. 2017-18] (contd...)

- In a case where the income is from a source other than assessable u/s. 68 to 69D, can such income still be subjected to tax u/s. 115BBE and consequential penalty u/s. 271AAC?**

SOME RECENT DECISIONS

- In favour of Revenue:

Sl. No.	Case reference	High Court/ITAT bench	Gist of case
1	<p>Suman Poddar <u>SLP (C) No. 26846/2019 (SC)</u> <u>dated 22/11/2019,</u> (2019) Taxmann.com 330 (SC)</p> <p><u>ITA 841/2019 (Del HC) dated 17/09/19</u> & <u>ITA 1006/Del/2019 (ITAT Del), Dated 25/07/19</u></p>	<p>Supreme Court</p> <p>Delhi High Court</p> <p>ITAT Delhi</p>	<p>The assessee had purchased shares of penny stock companies (Smartchamps IT & Infra Ltd.-later merged with Cressanda Solutions Ltd of Kolkata) at lesser amount in AY 12-13 and in AY 14-15 sold such shares at much higher amount. Assessee could not explain as to why it had purchased shares of such company whose financial position & net worth was negligible and how shares in an unknown company had jumped to higher value in no time, had carried out no other transactions with said broker. Transactions were held to be a part of planning of tax evasion even if transactions of purchase were through banking channels, sales was through banking channel & stock exchanges.</p>

SOME RECENT DECISIONS (contd..)

In favour of the Revenue (contd.....):

Sl. No.	Case reference	High Court/ITAT bench	Gist of case
2	<u>Udit Kalra ITA No. 220/2019 & C.M. No. 10774/2019 dated 08/03/2019</u> <u>ITA No. 6717/Del/2017</u> <u>Dated 08/01/2019</u>	Delhi High Court ITAT Delhi	Assessee had taken plea of denial of cross-examination of persons whose statements had led to inquiries. Long-term capital gains in penny scrip Kappac Pharma (having meager resources & consistent losses, astronomical rise in share prices in very short time, subsequently directed for delisting from stock exchange etc.) correctly denied by AO, CIT(A) & ITAT and does not give rise to any question of law.

SOME RECENT DECISIONS (contd..)

In favour of the Revenue (contd.....):

Sl. No.	Case reference	High Court/ITAT bench	Gist of case
3	Smt. Tharakumari <u>Tax appeal No. 128/2019 dated 11/02/2019</u>	Madras High Court	Assessee had neither produced evidences in her favour before authorities below nor appeared before ITAT. She could not show that the statement given by Deepak Patwari on oath on 22.07.2013 before the Directorate of Income Tax (Inv) Kolkata was incorrect, except for saying that she had no knowledge about the said person. Nothing was forthcoming from the Assessee as to how she identified the penny stock for investment and how she sold its shares. Long-term capital gains in penny scrip Luminaireire Technologies Ltd (having meager resources & consistent losses, astronomical rise in share prices in very short time, etc.) correctly denied by AO, CIT(A) & ITAT.

In favour of Revenue (contd.....):

Sl. No.	Case reference	High Court/ITAT bench	Gist of case
4	Sanjay Bimalchand Jain 89 taxmann.com 196 (Bombay) dated 10/04/2017	Bombay HC	Assessee purchased, in cash , shares of 2 Penny Stock Companies- Syncom Marketing Pvt. Ltd. and of Skyzoom Distributors Pvt. Ltd. Both Companies later merged with another Company, Khoobsurat Ltd of Kolkata. Sale of shares was at much higher amount. Assessee was unaware of the investment in 2 unknown Companies, shares of which were sold at a much higher price and no reason for such increase furnished. Broker did not respond to AO's letter seeking names and addresses of the purchasers. Transactions were held to be dubious transaction to account for undisclosed income in garb of LTCG and hence benefit of Sec. 10(38) is denied.

In favour of Revenue (contd.....):

Sl. No.	Case reference	High Court/ITAT bench	Gist of case
5	Satish Kishore & Naval Kishore ITA no. 1704 & 1705/Del/2019 dated 06/09/2019	ITAT Delhi	The assessee had purchased shares of various penny stocks companies (TTK Prestige, Suchak Trading, Risa International, Pawansut Holding, Tarang Projects) in cash in physical form at nominal amount and in about more than 1 year converted same into demat form & sold such shares at much higher amount through stock excahnges. The assessee had not tendered cogent evidence to explain as to why shares in an unknown company had jumped to such higher amount in no time and also failed to provide details of person from whom it purchased said shares & why the same were purchased off-market, claim raised by assessee and its plea for cross-examination of entry providers (whose statements Inv wing, Kolkata had recorded) was to be rejected even if transactions of sale were through banking channels & stock exchanges as AO had not relied merely upon statements of entry providers & assessee had failed to discharge burden of proof.

In favour of Revenue (contd.....):

Sl. No.	Case reference	High Court/ITAT bench	Gist of case
6	Shri Sanat Kumar <u>ITA no.</u> <u>1881/Del/2018</u> <u>dated</u> <u>14/06/2019</u>	ITAT Delhi	Where assessee claimed exemption under section 10(38) in respect of capital gain arising from sale of shares of Cressanda Solution Ltd, in view of fact that transactions were carried out subsequent to suspension of penny stock from BSE, assessee feigned ignorance about business and management of penny scrip, the penny stock did not have sound financials & price astronomically rose within short span of time, claim raised by assessee and its plea for cross-examination of entry providers (whose statements DRI had recorded) was to be rejected even if transactions of sale & purchase were through banking channels.

In favour of Revenue (contd.....):

Sl. No.	Case reference	High Court/ITAT bench	Gist of case
7	Pooja Ajmani <u>ITA no. 5714/Del/2018</u> <u>dated 25/04/2019</u>	ITAT Delhi	Where assessee claimed exemption under section 10(38) in respect of capital gain arising from sale of shares of Kappac Pharma, in view of fact that AO had taken into account findings of SEBI 7 investigation wing, the penny stock did not have sound financials & price astronomically rose within short span of time, claim raised by assessee was to be rejected even if transactions of sale & purchase were through banking channels.

In favour of Revenue (contd.....):

Sl. No.	Case reference	High Court/ITAT bench	Gist of case
8	Smt. M.K. Rajeshwari [2018] 99 taxmann.com 339 dated 12/10/2018	ITAT Bangalore	Where assessee claimed exemption under section 10(38) in respect of capital gain arising from sale of shares, in view of fact that financial worth of said company was meagre and, moreover, there was abnormal rise in price of shares, it could be concluded that assessee introduced her own unaccounted money in garb of long term capital gain and, thus, claim raised by her was to be rejected.

In favour of Revenue (contd.....):

Sl. No.	Case reference	High Court/ITAT bench	Gist of case
9	Shamim Bharwani <u>69 taxmann.com 65 (Mum.) dated 27/03/2015</u>	ITAT Mumbai	Where assessee claimed exemption under section 10(38) in respect of capital gain arising from sale of shares of penny stock- Emerald Commercial Ltd, in view of facts that purchase of shares was off market, purchase was not reported in the stock exchange, the purchase was through a back dated contract note in cash and, there was no trail, the shares belonged to a penny stock company with no credentials whose selling rates were artificially hiked with no real buyers, claim raised by assessee was rejected.

In favour of Revenue (contd.....):

Sl. No.	Case reference	High Court/ITAT bench	Gist of case
10	<p>Sudhir Balraj Jumani HUF (ITA No. 1570/Ahd/2012) dated 04/08/2016</p> <p>Rohit Jayantilal Shah (ITA No. 866/Mum/2016) Dated 15/09/2017</p>	<p>ITAT Ahmedabad</p> <p>ITAT Mumbai</p>	<p>Where assessee did not submit delivery notes, demat account etc and the penny stock (which otherwise also had meager profits) also had gone into liquidation, assessee's plea for cross-examination of entry providers and assessee's appeal dismissed & action of authorities below to treat the LTCG on penny stock of Buniyad Chemicals (part of Mukesh Choksi/Mahasagar group of accommodation entry providers), as bogus transaction and making addition to total income was upheld.</p> <p>Where assessee submitted contract notes & purchase bills but same pertained to broker not registered with stock exchanges (and was part of Mukesh Choksi/Mahasagar group of accommodation entry providers), payment was made more than 6 months of purchase and the penny stock had meager profits, assessee's plea for cross-examination of entry providers and assessee's appeal dismissed & action of authorities below to treat the LTCG on penny stock of Jai Corp Ltd as bogus transaction and making addition to total income was upheld.</p>

SOME RECENT DECISIONS

In favor of assessee

Pr. CIT Vs. Prem Pal Gandhi – I.T. Appeal No. 95/2017 dated 18.01.2018 (P&H)

Shares purchased of Rs. 11 lakhs in cash paid just before its dematerialization. Worth of the Company not proved. The sale of shares for a consideration of Rs. 4.23 Crores suggests non-genuineness of the transactions.

The Hon'ble Court held –

The shares were traded on NSE, the payments are made from explained sources and receipts are routed through bank. The assessee had even received dividend on such shares. No evidence to link any manipulation in any manner. The addition being made on suspicion could not be sustained.

SOME RECENT DECISIONS

In favor of assessee (Contd...)

Ramniwas Ramjivan Kasat 82 taxmann.com 458 (Guj) Order dated 05.06.2017

The AO noted that purchase of shares itself was bogus and, therefore, sale proceeds were added as unexplained cash credit.

The findings of the Tribunal that purchase of shares was in the previous assessment year which is accepted as genuine in the assessment for that year.

Hence the sale and income therefrom could not be treated as unexplained.

CIT Vs. Shaym R. Pawar 54 taxmann.com 108 (Bombay) dated 10.12.2014

Where DMAT account and contract note showed details of share transaction, and Assessing Officer had not proved said transaction as bogus, capital gain earned on said transaction could not be treated as unaccounted income under section 68

Possible inquiries to be conducted by AOs

- **Ask assessee for –**
 - *Contract notes, bills & confirmation of broker both for sale and purchase transactions,*
 - *Demat account, bank statement reflecting relevant receipts and payments,*
 - *Justification for purchasing shares of penny stocks despite poor financials, who advised such purchases, copy of share-purchase agreement, whether and when any periodic analysis of performance of penny stocks was done by assessee so as to secure its' so-called investments, how, when & to whom instructions were given for purchase and sale (phone/email/written) etc.*

Possible inquiries to be conducted by AOs

- Inquire directly with broker, Demat registrar & NSE/BSE about genuineness of documents submitted by assessee, to ascertain market-price on days of purchases/sales and to know the day of actual delivery in demat account.

In one case of Inv. Wing, the ITO got copies of demat transfer slips. He could see that the demat transfer slips mentioned shares as 'pledge' instead of 'sale'. Thus, the reasons for transfer were not genuine. The assessee subsequently surrendered the income.

- In case of off-market sale/purchases, inquire directly about the seller/purchaser and also inquire his creditworthiness, genuineness etc. If sources of purchases non-genuine, see applicability u/s 68/69 of I.T. Act.

Possible inquiries to be conducted by AOs (Contd.....)

Sample of trade data from NSE/BSE (about 45 columns)

SCRIPCODE	SCRIPNAME	TRADE_DATE	TRADE_EID	TRADE_TIME	QTY	RATE	TRADE_VOLUME	MEMBER_NO	MEMBER_NAME	Member Address	CLIENT_CODE	CLIENT_NAME	NON_CLIENT_NAME	CLIENT_ADDRESS	CLIENT PHONE	PANNO	CLIENT_STATUS	CLIENT_TYPE
531216	COMFORTINTC	01-04-2011	1001	09.15.44.214113	1	2.7	2.7	3018	ARCADIA SHARE & STOCK BROKERS PVT.LTD.	328, Ninad, 1st Floor, Building No.7 Service Road, Bandra (East), Mumbai, Maharashtra-400051	OG9709	JUGAL KISHORE SOMANI	JUGAL KISHORE SOMANI	220 B NADI MOHALLA JODHPUR RAJASTHAN INDIA 306401	9314706927	AKCPS7746R	CL	CLIENT

TRADE_TYPE	ORDER_NO	LOCATIONID	ORDER_TIME	USER_NAME	USER_ADDRESS	LOG_TERM	BUYSELL	CP_MEMBER_NO	CP_MEMBER_NAME	CP_MEMBER
.	16000031000416	11111111111111001	09:15:44.173779	SAKSHI N ARTE	328 NINAD CO OP HSG SOCIETY 1ST FLOOR SERVICE ROAD BANDRA (E) MUMBAI MAHARASHTRA 400051	228	B	470	SMC GLOBAL SECURITIES LTD.	

CP_CLIENTCODE	CP_CLIENTNAME	CP_NON_CLIENT_NAME	CP_CLIENT_ADDRESS	CP_CLIENT PHONE	CP_PANNO	CP_CLIENT_STATUS	CP_CLIENT_TYPE	CP_TRADE_TYPE	CP_ORDER_NO	CP_LOCATIONID
CELC	ELCON INVESTMENT		24/B KOLKATA WEST BENGAL INDIA 700006	9999999999	ADPPB9552N	CL	CLIENT	L	12000034000049	7000060164001001

CP_ORDER_TIME	CP_USER_NAME	CP_USER_ADDRESS	CP_LOG_TERM
09:15:01.298036	TARUN KUMAR PAKHIRA	24B KOLKATA WEST BENGAL 700006	203

Possible inquiries to be conducted by AOs (Contd...)

- Inquire with SEBI directly/and/or through SEBI website to know about status of orders/inquiries on concerned penny scrip.
- Inquire about sources of purchases. *In one case, the funds of penny stock-company itself had been given to assessee as unsecured loans to purchase shares of penny scrip itself, which is in contravention of SEBI regulations.*

Many times, purchase is in cash, off-market and through untraceable parties/brokers. Ascertain from NSE/BSE/SEBI website whether such parties/brokers are not registered brokers/suspended from stock-exchanges/barred by SEBI.

Possible inquiries to be conducted by AOs (Contd...)

- Inquire from the share-registrar of penny scrip about all shareholders and their holding during the period when assessee held such shares. Name of Share-registrar is mentioned in prospectus filed by penny scrip with SEBI or in its' annual report (mostly available on internet).

In one case, from inquiries with share-registrar, assessee was found to have held less than 5% of shares of penny scrip on the date where assessee had claimed to have acquired (off-market) more than 25% of total shares. This proved that off-market purchases were back-dated.

Further, in case of acquiring more than 25% shares, public announcement for acquisition has to be made in as per SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

Possible inquiries to be conducted by AOs (Contd...)

- In many of the cases, assessees rely on Board's Circular No. 704, dated 28-4-1995, which contains:*In case the transactions take place directly between the parties and not through stock exchanges, the date of contract of sale as declared by the parties shall be treated as the date of transfer provided it is followed up by actual delivery of shares and the transfer deeds.*" .

The crucial words here are *"In case the transactions take place directly"*. So, AO should examine the records of counter-party as in previous slides. Also, SEBI had vide *Circular No.SMDRP/POLICY/CIT-32/99 dated September 14, 1999* banned all negotiated deals including cross-deals and all such deals are required to be executed only on the screens of the exchanges in the price and order matching mechanism of the exchange just like any other normal trade. Thus, off-market deals are not in conformity with regulatory guidelines of SEBI.

- Discrepancies found in respect of above & inquiries as suggested in earlier slides should form part of assessment order.

Possible inquiries to be conducted by AOs (Contd...)

- Analyze financials and share-price of penny scrip in detail and reproduce the same in assessment order along with SEBI order, if any.
- In case any other penny scrip (apart from the scrip which is part of reasons of reopening or CASS criterion) is found, AO should inquire about the same also to ascertain the genuineness of claim of assessee. However, such full-scale inquiries need to be conducted only in full scrutiny cases under CASS or u/s 148 since limited CASS cases have to confine to only the issues at hand.
- Even if only purchase transaction of penny scrips has taken place in the concerned AY, the AO should bring out in assessment order that transactions are non-genuine so that later on, in year of sale, assessee can not claim that purchases had not been held as bogus.



THANK YOU