

(2012) 07 MAD CK 0007

In the Madras High Court

Case No : Tax Case (Appeal) No. 1144 of 2006 (Block period 24th Feb., 1988 to 24th Feb., 1998)

Rajani Hotels Ltd.

APPELLANT

Vs

Dy. CIT

RESPONDENT

Date of Decision : 20-07-2012

Acts Referred:

Income Tax Act, 1961 — Section 131, 132A, 158BC, 68

Citation : (2012) 07 MAD CK 0007

Hon'ble Judges : K. Ravichandra Baabu, J;Chitra Venkataraman, J

Bench : Division Bench

Advocate : R. Janakiraman, for the Appellant; T. Ravikumar, for the Respondent

Judgement

Chitra Venkataraman, J.—The following are the substantial questions of law raised in this tax case appeal filed by the assessee:

(i) Whether on the facts and in the circumstances of the case the Tribunal was right in law in holding that a part of share capital is the income of the

appellant on the alleged ground that the shareholders are not genuine?

(ii) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the share capital can be termed as ""unexplained

investment"" by the appellant?

(iii) Whether on the facts and in the circumstances of the case, the Tribunal was right in treating the share capital as income of the appellant even

though no business was commenced by the appellant?

The assessment herein is a block assessment for the block period 24-2-1988 to 24-2-1998. It is seen from the narration in the orders of the

authorities below that on 25-2-1997, there was a search in the premises of the assessee by the Enforcement Directorate, during which time, the

Enforcement Directorate seized certain books and documents relating to the assessee. They were thereafter handed over to the Department and

warrant u/s 132A was issued. On the recovery of materials, notice u/s 158BC was issued to the assessee to furnish the return of income. The

assessee filed a nil return along with a letter questioning the issue of notice when there was no search carried out in the premises of the assessee.

The assessee further submitted that the company had not commenced any business, and as the return had to be filed before 10-5-1998, it filed a

nil return that there was no undisclosed income to be assessed at the hands of the assessee.

2. It is seen from the facts that the company had acquired a property at No. 6, Santhome High, Road, Chennai, at a cost of Rs. 2.5 crores. The

sources were stated to be mainly out of the share capital received locally as well as from NRI and OCB. The assessee was requested to furnish

the total amount received towards share capital and the details of share application money pending for allotment. The assessee filed the details as

regards the names of shareholders and the amount contributed and the mode. On a perusal of the balance sheet for the year ending 31-3-1995,

31-3-1996 and 31-3-1997, it was ascertained that the total subscribed capital was to the tune of Rs. 2,34,22,720. Apart from that, a further sum

of Rs. 47,79,480, which was the share application money, was pending allotment as on 31-3-1997. Summons were issued u/s 131 of the IT Act

and enquiry was conducted as regards those applicants who were stated to be from Jaipur, Bangalore, Thanjavur, Coimbatore and Chennai. The

enquiries conducted at Jaipur revealed that most of them said that they had not applied to the assessee for share allotment. Those persons who

were assessed to tax, had also filed proof, indicating that they had not subscribed to the shares at all. The assessee was confronted with this

enquiry result, indicating the state of affairs.

3. Pursuant to the notice, the directors Mr. Pannalal Jain, Mr. V.N. Chandrasekaran and Mr. Ramasamy, appeared before the officer and filed a

sworn statement. When confronted with the statements made that they were benami investments, Mr. Pannalal denied the allegation. However, on

a perusal of the share transfer register, it was found that the shares were transferred to Mr. Pannalal. The officer viewed that the share application-

money was made only through cash and the payment made to the Individuals were also by way of cash. Thus the claim of Mr. Pannalal was rejected.

4. The officer pointed out that the assessee had not filed any objection to the proposed addition made. Referring to the decision of the Full Bench of the Delhi High Court in Commissioner of Income Tax Vs. Sophia Finance Ltd., the AO held that a sum of Rs. 6,69,000, said to have been invested by 34 individuals, were to be assessed as undisclosed income u/s 68. As regards the enquiry made at Bangalore, in respect of an investment of Rs. 46,000, the officer pointed out that there was no such addressee. Thus the said amount was added, to be assessed at the hands of the assessee.

5. As regards the enquiry made at Thanjavur, the officer recorded the statement from one Mahalingam in whose name the application stood. On enquiry, it was found that without the knowledge of the said Mahalingam, the shares were applied for and got allotted, which were subsequently transferred to the name of Chandrasekaran. Thus, a sum of Rs. 75,000 was treated as undisclosed income of the assessee. The state of affairs as far as Coimbatore is concerned, was not different and the applicant therein had no connection with the assessee. Consequently, a sum of Rs. 24,000 was added as income of the assessee.

6. As regards the enquiry made at Chennai, there were 23 individuals involved in the alleged transaction, on which, a sum of Rs. 1,18,200 was made by way of cheque. The officials found that the assessee could substantiate the transactions only in respect of 14 cases and in rest of the cases, it remained unexplained. Thus, a sum of Rs. 1,70,000 was treated as unexplained at the hands of the assessee. The officer further pointed out that in respect of Rs. 1,70,000, there was no response and there was further sum of Rs. 50,000 pending allotment. Thus, on the basis of the enquiry, the amount was sought to be assessed at the hands of the assessee.

7. Aggrieved by the same, the assessee went on appeal before the CIT(A), wherein, the assessee took the stand that the assessee had not commenced its business as on date and hence, there could be no undisclosed income at the hands of the assessee for the above said block period.

In considering the plea of the assessee, the CIT(A) pointed out to the decision of

the Delhi High Court i Commissioner of Income Tax Vs. Stellar

Investment Ltd., wherein, the Delhi High Court had taken the view that in the case of bogus shareholders in whose names shares had been issued,

the money might have been provided by some other persons. In the circumstances, the amount of increased share capital could not be assessed at

the hands of the company as undisclosed income. The Delhi High Court reasoned out that if the assessment of those persons who had really

advanced the money were sought to be reopened, it would have made some sense, on the score that the assessment stood in the name of benami,

but it would not, in any manner, justify the assessment at the hands of the assessee as an undisclosed income. The said decision of the Delhi High

Court was taken on appeal before the Apex Court in the decision in Commissioner of Income Tax Vs. Steller Investment Ltd., wherein the Apex

Court rejected the Revenues appeal on the ground that the decision was based on factual finding. In the circumstances, the CIT(A) agreed with the

assessee that the unexplained money at the hands of the assessee could not be assessed as an undisclosed income. Aggrieved by this, the Revenue

went on appeal before the Tribunal, which allowed the Revenues appeal.

8. The Tribunal pointed out that the surrounding circumstances clearly led to the conclusion that there was no genuine transaction. In any case,

where the public issue was not in doubt, it could not be conceived as to how any share capital contribution could be assessed as income of the

company, for the reason that only some of the applicants were not able to explain the source of funds invested; by them. At the same time, when

the facts and circumstances justified the finding that what had been credited as share capital was actually not so, section 68 permits the officer to

make various enquiries in this regard and\based on the resolution of the enquiry, treat the amount as unexplained income of the company.

9. As far as the present case is concerned, the Tribunal pointed out that the enquiries revealed that the applicants were not real; consequently, it

upheld the assessment and reversed the order of the CIT (A). Aggrieved by the same, the present appeal has been preferred by the assessee.

10. Learned counsel appearing for the assessee pointed out that the assessment, made as block assessment, is bad in law; hence, the same could

not be sustained. He further pointed out that going by the decision of the Delhi

High Court, confirmed by the Supreme Court in the decision reported in CIT v. Steller Investment Ltd. (supra) and coupled with the fact that the assessee had not yet commenced its business as on date, the Tribunal was not justified in treating a sum of Rs. 11,71,000 as unexplained income at the hands of the assessee. He further pointed out that when the business itself had not yet commenced, the question of taking recourse to s. 68 of the IT Act to treat the share application money as unexplained income, did not arise. In any event, the assessee had placed materials to discharge his burden to show that there was an application for allotment of shares and the amount paid was share application money; consequently, the assessment has to fail. He also placed reliance on the unreported decision of this Court in Tax Case No. 495 of 2011, dated 14-11-2011 (CIT v. AKS Alloys (P) Ltd.) and submitted that their claim merited to be allowed.

11. He also referred to the decision of the Apex Court in Commissioner of Income Tax Vs. Lovely Exports (P) Ltd., that there is always an option to the Revenue to proceed against the individuals who had made applications and when the share application money is received by the assessee from the alleged shareholders, the same cannot be regarded as undisclosed income of the assessee. In the circumstances, he pleaded for setting aside the order of the Tribunal.

12. As far as the plea on the validity of application for share allotment is concerned, the assessee had not placed any such ground before any of the authorities below, including the Tribunal, and rightly no question of law was also framed in the appeal filed before this Court.

13. As regards the assessment of Rs. 11,71,000 towards unexplained cash at the hands of the assessee, a reading of the decision of the Delhi High Court in CIT v. Steller Investment Ltd. (supra) on which heavy reliance was placed by the assessee, shows that originally, the AO accepted the increase in the subscribed capital of the company. Thereafter, in exercise of revisional jurisdiction, the CIT held that there was a device of converting black money into white money by issue of shares with the help of formation of an investment company, and that there was no enquiry on the genuineness of subscription to the share capital. The Delhi High Court pointed out that it might be that there were some bogus shareholders in

whose names shares had been issued and the money might have been provided by some other persons. The High Court observed that if the

assessment of the persons who were alleged to have really advanced the money was sought to be reopened, that would have made some sense,

but that it failed to understand as to how this amount of increased share capital could be assessed in the hands of the company itself.

14. The said judgment was considered by the Full Bench of the Delhi High Court in the decision reported in CIT v. Sophia Finance Ltd. (supra).

The Full Bench pointed out that if the shareholders are identified and it is established that they had invested money in the purchase of shares, then

that would be a capital receipt and to that extent, the observations in the decision in CIT v. Steller Investment Ltd. (supra) would be correct;

however, the observations in the decision in CIT v. Steller Investment Ltd. (supra) to the effect that even if the subscribers to the capital were not

genuine ""under no circumstance could the share capital be regarded as undisclosed income of the company"" would not be correct. Referring to

section 68 of the IT Act, the Delhi High Court held that the ITO had the jurisdiction to make enquiries as regards the nature and source of a sum

credited in the books of account of the company. The mere fact that the assessee chooses to show the receipt of money as capital, it would not

preclude the ITO from going into the question whether this is actually so. If the shareholders exist, then no further enquiry need be made; but where

the ITO finds that the alleged shareholders do not exist, then, in effect, it would mean that there would be no valid issuance of share capital and the

shares could not be issued in the name of non-existing persons. Thus referring to the decision in Commissioner of Income Tax, Calcutta Vs. Biju

Patnaik, the Full Bench of the Delhi High Court held that the ITO was bound to enquire whether the cash credits found in the books of accounts of

the assessee were genuine or not and if the enquiry showed that the persons in whose name the amount stood are not in existence or are not

genuine, it is always open to the AO to treat it as unexplained income of the assessee.

15. The decision in CIT v. Steller Investment Ltd. (supra) held that so long as there are persons available to link the credit entry in the company's

account to those names, the question of treating these entries as unexplained income of the company does not arise.

16. Thus one can discern from the decision of the Full Bench of the Delhi High Court in CIT v. Sophia Finance Ltd. (supra) that only in cases

where there are no existing persons shown to have had a link to the deposit, in the sense that it is not a case of benami transaction and that the very

existence of such a person is in question, then the treatment of entry as an undisclosed income would arise. However, in a case of benami

transaction where the shares are shown in the name of one and money might have been provided by some other persons, the treatment that one

may meet out in the case of non-existent persons, however, would not arise in treating the credit entries as undisclosed income of the company.

17. As far as the present case is concerned, while some of the shares were benami, as for example, in the case of enquiry made in Thanjavur as

well as in Jaipur, in respect of other transactions, i.e., in Bangalore, Coimbatore and Chennai, it is difficult to accept the case of the assessee that

the unexplained share application money should not be treated as unexplained income of the assessee as per section 68.

18. As already seen, the assessment order shows that in respect of an enquiry made at Jaipur, some of these shares were transferred to Mr.

Pannalal. The total amount found in respect of Jaipur transaction was to the tune of Rs. 6,69,000. We do not find the details as to how many

shares stood in the name of Pannalal, to hold that extent of income assessed as a capital. This requires enquiry at the hands of the officer to find out

that on Rs. 6,69,000, standing in the name of the company's share application money of 34 individuals, how many shares stood transferred to

Pannalal. The amount which is referable to the shares transferred to Pannalal has to be necessarily excluded from the undisclosed income of the

company and the unexplained balance amount not standing in any existing persons name, could be treated as undisclosed income of the assessee.

19. As far as the enquiry at Thanjavur is concerned, the share applications were in the name of Mahalingam, who happened to be the brother of

V.N. Chandrasekaran, one of the directors of the company. It was seen that the shares were allotted to Chandrasekaran. Considering the above

said aspect, applying the decision of the Full Bench of the Delhi High Court in CIT v. Sophia Finance Ltd. (supra), we have no hesitation in holding

that the sum of Rs. 75,000 could not be treated as an undisclosed income at the hands of the company.

20. As far as the enquiry made in Chennai is concerned, a sum of Rs. 1,70,000 remains unexplained by the assessee. Consequently, barring this amount of Rs. 1,70,000, a sum of Rs. 1,41,000 merits to be treated as explained and hence, cannot be treated as an unexplained income at the hands of the assessee. Thus, on going through the orders before us, we are satisfied that the assessee is entitled only to a partial relief, namely as regards Rs. 1,41,000 relating to the Chennai, Rs. 75,000 relating to Thanjavur and as far as Jaipur is concerned, subject to the verification of the records indicating the shares transfer to Mr. Pannalal, the liability has to be worked out. In the light of the above, we partly allow the assessee's case. To that extent that we have indicated above, we set aside the order of the Tribunal.

21. As far as the third substantial question of law is concerned, learned counsel appearing for the assessee submitted that the Tribunal committed a serious error in treating the share capital as an income of the assessee, even though no business was commenced by the assessee. As already pointed out, when the assessee had not substantiated its case before the AO as to the persons who had contributed and as to who had made the applications for share allotment, rightly, the AO took recourse to s. 68 and the only available course was thus to treat the unexplained amount available at the hands of the assessee as an unexplained income. It is seen from the assessment order that till the date of passing the order of assessment, the assessee had not filed any objection to the proposed addition made. Thus, in the absence of any explanation, the only course open to the officer was to treat the amount at the hands of the assessee as an unexplained income. In the light of the order passed by us, as indicated above, except to the extent of the relief as stated above, the assessee is not entitled to any relief and hence, the unexplained entries were rightly treated as unexplained income of the assessee. In the circumstances, the tax case stands partly allowed. It is open to the Department to make necessary assessment on Pannalal and others in whose names the shares stand, after verifying the records, and subject to the provisions of the IT Act. No costs.