# Daily Tax News (DTN)

**Huzaima & Ikram**
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# SECP: Defending the indefensible

by
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Security and Exchange Commission of Pakistan (SECP) is relentlessly justifying a black money whitening scheme introduced through Presidential Ordinance on 24 April 2012—this is nothing but defending the indefensible. The Finance (Amendment) Ordinance, 2012 promulgated a day before the scheduled session of Parliament extending benefits to tax evaders and owners of dirty money is morally sacrilegious and legally offending inalienable fundamental right guaranteed under Article 4 of the Constitution. The simple question is what prevented the government to present it as a Bill in the Parliament? Does giving cover to black money not tantamount to facilitating money launderers? By just writing a letter to the Managing Directors of three stock exchanges in the country "that the new law only gives immunity under Income Tax Ordinance, 2001" the SECP cannot validate what is patently unlawful enactment.

SECP must be aware of the fact that one of the worst consequences of black money is its pernicious effect on the general moral fabric of society. It puts integrity at a discount and places a premium on vulgar and ostentatious display of wealth. This shatters the faith of the common man in the concept of dignity of honest labour and virtuous living. It is therefore, no exaggeration to say that ill-gotten wealth is like a cancerous growth in the economy of any country, which, if not checked in time, would culminate in its doom.

In the article, '**Finance (Amendment) Ordinance, 2012: Controversial and questionable**" [*Business Recorder*, May 11, 2012], it was established why the SECP shown enthusiasm in this whitening scheme. In its dispatch to stock exchanges, the SECP stated that the Finance (Amendment) Ordinance, 2012, under which the tax department would not ask questions on the source of funds invested in stocks up to 30 June 2014, "is not all inclusive". It was reported in the Press that "the money suspected to be channeled into the stocks in contravention of Anti-Money Laundering Act, 2010 would remain open to questions. The letter in essence, therefore, sifts the money invested in stock market, between legal and criminal, more than between black and white or documented and undocumented". The text of communique sent to the stock exchanges by the apex regulator dated May 8, 2012 reads:

> **"Pursuant to amendments in the Income Tax Ordinance, 2001 notified through the Finance (Amendment) Ordinance 2012 dated April 24, 2012 whereby provisions related to Capital Gain Tax (CGT) for the stock market investment have been implemented, the stock exchanges are advised to immediately circulate the following for compliance of the members/brokers:**

> **The said provisions shall only be applicable under the Income Tax Ordinance, 2001 (ITO) and does not bar asking source of income under any other law including Anti-Money Laundering Act, 2010 (AMLA). Therefore, the exemption under these provisions is not available for income derived from a criminal activity under any other law for the time being in force.**
>
> **Second, the requirements of AMLA and the rules and regulations made there under are not affected by these provisions of the ITO and no exemption, in whole or in part, is available for any AML/CFT preventive measures under the AMLA. The KYC/CDD and Suspicious Transaction Report (STR) reporting requirement vide stock exchange regulations and guidelines dated Feb 1, 1012 shall continue regardless of the above amendments. Therefore, brokers shall take reasonable measures for establishing the source of wealth and source of funds for high risk customers and also to obtain sufficient information to determine the expected source of funding for the account.**
>
> **Third, the Financial Monitoring Unit may refer any STR to tax authorities notwithstanding the provisions of ITO and tax authorities will continue to cooperate with law enforcement agencies on AML matters."**

According to a Press report, the SECP's letter alerted stock brokers regarding Section 33 of the AML Act 2010, which *inter alia* specifically provides for criminal sanctions on failure to file STRs and for providing false information. SECP warned that in case any member/broker was found to be in violation of above legal requirements, a simultaneous regulatory action would be initiated. It was reported in the Press that "while most brokers during the weekend were taking the SECP's note in stride and some even feigned ignorance about the red flag—understandably to soothe investors' nerves and dispel any panic in the market when it opened on Monday [May 14, 20120], one senior broker asserted that there was nothing new in the SECP note".

No significant compliance of AML Act 2010 has been made by banks, non-banking financial institutions and stock markets in Pakistan. This, like many others, is just a statute on paper. Already the brokers are required to file an undertaking every 15 days, certifying that there was no violation of Anti-Money Laundering Act, 2010 in the ranks of their clients and that the brokerage was following the 'know your clients' criteria. But there is hardly any such reporting showing as if everybody is paying tax in Pakistan and source is made available to tax department. Had this been the case what was the need of immunity for investors in stocks?

Nadeem Naqvi, Managing Director of the Karachi Stock Exchange while commenting on the SECP's letter opined that it was being taken 'out of context' in interpretation. He said that it was a mere 'clarification' and did not cause change in the already declared provisions of CGT. Mr. Naqvi revealed that two months ago, the bourse had further tightened the tap for scrutiny of funds entering the stock market by issuance of guidelines for brokers to conform to the AML. "If sufficient suspicion exists that any money flowing in was in contravention of AML or Anti-terror laws, a scrutiny could always be made by the Anti-terrorism or AML task force," he added. He was of the view that unfolding the letter on May 11, sent by the SECP on May 8, was of little consequence for the information was not 'price sensitive'. "The plunge of 383 points in the KSE-100 index in the last two days of the previous trading week", he said, was not the cause of leakage of information to some selected investors, but the result of a flare up in US-Pak relationship and secondly the payment of dues to Independent Power Producers (IPPs) through the OGDC—the highest weighted scrip on the KSE-100 index, which many thought would impact the valuation of the big stock.

Whatever is claimed by SECP or Mr. Naqvi, the fact remains that major provision of the Eighth Schedule to the Income tax Ordinance, 2001, inserted by the Presidential Ordinance of 24 April 2012 relating to "no questions to be asked on funds invested in stocks till June 2014" offends Anti-Money Laundering Act of 2010 and Article 7 of the United Nations Convention Transnational Organised Crime. There would certainly be no meaningful reporting by brokers as has been practice in the past. The real issue is illegality of this enactment giving free hand to tax evaders—providing such a facility is void ab initio. One wonders how the government opted to introduce such a law, through back channel bypassing the Parliament, when early this year, Pakistan along with four other countries, was blacklisted by the Financial Action Task Force (FATF), an inter-governmental body working to combat money laundering and financing terrorists.

Pakistan is facing a grim challenge of measuring and countering enormous black money—it's size is estimated to be three times the regular economy. Till today, no serious effort has been made by the National Accountability Bureau (NAB), Federal Board of Revenue (FBR), Federal Investigating Agency (FIA), and Anti-Narcotics Force (AFN) to constitute a joint task force to unearth and counter outflow and inflow of dirty money. On the contrary, SECP is defending money whitening scheme, which is a unprecedented for any regulator in the world.

Successive governments—military and civilian alike—have been pardoning the corrupt and appeasing tax evaders through various laws and amnesty schemes. The result is obvious. There is an ever-growing informal economy undermining national growth and promoting lack of transparency in all spheres of life. Political culture is fraught with favours to those having money power and control over economic resources —both, anti-thesis of a true democratic set-up.

Pakistan, by all means has become a place well suited for illegal gains. The corrupt control all spheres of life, and stock exchanges are no exception. They real strength is money power through which they can bend and bribe anybody. The country cannot recoup financially unless the very foundations of corruption and rent-seeking are destroyed. Policies of appeasement towards criminals, plunderers of the national wealth and tax evaders must be abandoned without any further delay. Unless the State shows determination and sternly cracks down on the underground economy, the citizens will never pay their taxes. Acts like giving amnesty to the big fish in stock trade dissuade them from having faith in system. Such steps will not only further tarnish the already rogue image of Pakistan as a haven for money launderers but also going to increase the woes of the honest and law abiding citizens in general and that of taxpayers in particular.

**Illegal input tax adjustments: Chain-audit of manufacturers, wholesalers begins**

The 'Special Sales Tax Monitoring Team' of the Federal Board of Revenue (FBR) has started chain-audit of manufacturers and wholesalers on detection of "fly-by-night" type of wholesalers, who only setup their businesses to facilitate unscrupulous manufacturers/ exporters in claiming unlawful input tax credits/refunds against bogus invoices.

Sources told here on Tuesday that chain-audit of all manufactures and wholesalers would be conducted in cases where they have adjusted input tax in excess of 90 percent and 97 percent of the output tax respectively.

It is a major development that the FBR's 'Special Sales Tax Monitoring Team' has unearthed this new kind of tax fraud by wholesalers, who temporarily setup their offices to commit frauds causing massive loss to the national exchequer.

The recently constituted team has exclusively started working on the illegal input tax adjustments on national level.

The chain audit of all wholesalers would verify payment of input tax credit claimed by them to track the chain and establish backward linkages with regard to supplies received by the manufacturers and wholesalers from their respective suppliers.

It has also been observed that most of the fake/ bogus sales tax invoices used for claiming inadmissible input tax credit / refund are issued by the "fly-by-night" type of wholesalers, who setup their business only to facilitate certain unscrupulous manufacturers/exporters in claiming unlawful input tax credits & refunds against the bogus tax invoices, thereby incurring loss to the public exchequer.

In this connection, the FBR on Tuesday issued instructions to the Large Taxpayer Units (LTUs) and Regional Tax Office (RTOs) to immediately conduct chain-audit of all manufacturers and wholesalers.

According to the FBR's instructions, the section 8-B (1) of the Sales Tax Act, 1990, restricts taxpayers registered as "Manufacturer" from deducting input tax as in excess of 90 percent of their output tax liability, subject to the exclusions provided under SRO 647(1)/2007 dated 27$^{th}$ June, 2007.

However, snap audit conducted by the Special Monitoring Team of FBR revealed that a large number of taxpayers registered in the category of “Manufacturer” have claimed input tax credit much in excess of 90 percent of their output tax liability.

A synopsis indicating details of such manufacturers who have shown their input tax in excess of Rs 100 million during fiscal year 2010-11 and Rs 75 million during 2011-12 (up to March, 2012); and claimed credit/adjustment thereof over & above 90 percent of their output tax liability, has been compiled for ready reference.

Likewise, “wholesalers”, who generally operate with a minimum value addition / profit margin of 3-5 percent, are claiming input tax adjustment much over 97 percent of their output tax liability, as revealed during snap audit conducted by the Special Monitoring Team of FBR.

The FBR's instructions said that a synopsis indicating details of such wholesalers who have shown their input tax in excess of Rs 500 million during fiscal year 2010-11 and Rs 375 million during 2011-12 (up to March, 2012); and claimed credit/adjustment thereof over & above 97 percent of their output tax liability, has been compiled for ready reference.

The FBR further said that it has also been observed that most of the fake/ bogus sales tax invoices used for claiming inadmissible input tax credit / refund are issued by the “fly-by-night” type of wholesalers, who setup their business only to facilitate certain unscrupulous manufacturers/ exporters in claiming unlawful input tax credits & refunds against these bogus tax invoices, thereby incurring loss to the public exchequer.

In view of the position explained above, it is requested that a Special Audit Team, headed by an officer of Inland Revenue Service, not below the rank of an Additional Commissioner, comprising experienced / skilled IR Audit Officers may immediately be constituted and assigned the task of carrying out detailed chain audit of all such manufacturers who have claimed input tax credit in excess of 90 percent of their output tax liability during any month of the tax years 2009-10, 2010-11 and 2011-12 (up to April, 2012).

The Audit Team so constituted may be advised to take into consideration the exclusions as provided under SRO 647(1)/2007 dated June 27, 2007 while conducting chain audit.

The Audit Team shall also carry out detailed chain audit of all wholesalers for the aforesaid period to verify payment of input tax credit claimed by them, by using the “Sales Tax Monitoring &

Analytical Reporting Tool" (SMART) to track the chain and establish backward linkages with regard to supplies received by the manufacturers and wholesalers from their respective suppliers.

The audit shall be completed and report be sent to the Board on or before 30th May, 2012 positively and in case of short / non payment of sales tax, immediate recovery action shall be initiated to ensure that such short / unpaid amount of sales tax is deposited in the government treasury during the currency of fiscal year 2011-12, FBR's instructions said.

The taxpayers ie manufacturers and wholesalers audited by the Audit Teams of field formations may be re-audited on random basis by the Special Audit Team of FBR, and in case any audit report is found deficient, strict action shall be taken against the concerned teams of the field formations, FBR's instructions added. – *Courtesy Business Recorder*

**Reasons behind distribution of 80 percent GST among provinces cited**

The National Finance Commission (NFC) meeting has decided to distribute 80 percent instead of the entire GST collection on services to provinces to avoid the complication of input output adjustments and sales tax refunds at a later stage.

Sources told here on Tuesday that the federal government decided to withhold 20 percent of total GST on services collected (minus one percent collection fee charged by the Federal Board of Revenue) from the three provinces - Punjab, KPK and Balochistan - to take account of their refund on account of input output adjustments in future.

The 100 percent distribution of GST on services has not been made to the provinces in view of the probability of input/output adjustments and refunds.

The argument employed for withholding 20 percent of the total GST on services collections, as per a senior official of the Ministry of Finance, was as follows: in case the provinces have to make some refunds out of the total distributed to them on account of GST on services due to input output adjustments, it may create problems for them to refund the already received amount.

Hence, the meeting decided that 80 percent of total collections till December 2011-12 distributed among provinces on a temporary basis till a distribution formula is finalized.

Sources said that the earlier distribution formula for collection of GST on services was agreed between the federation and provinces as per record note signed by the provinces.

The formula became redundant after the collection of GST on services by the Sindh government through the Sindh Revenue Board (SRB).

Sindh government argues that the sales tax on services is primarily a provincial subject whereas viewpoint of other provinces is that technically it is not so simple because of cross border transactions and input output tax adjustments.

Until new formula has been agreed, it was decided by the National Finance Commission (NFC) that 80 percent of the total GST collection on services would be distributed among the provinces till the new distribution formula is not agreed.

Presently, Sindh is collecting GST on services whereas the other three provinces have delegated powers to the Federal Board of Revenue (FBR) for collection of sales tax on services on their behalf.

A top official of the economic team told that the FBR is yet to transfer the amount of GST on services pertaining to 2011-2012 to Punjab, KPK and Balochistan.

If the total collected amount on account of GST on services has been distributed among three provinces and later if an issue of input output adjustment arises, it could lead to a complication in refund.

To avoid such a situation where refunds would arise, an arbitrary percentage of 80 percent has been agreed by the provinces and federal government.

Thus a precautionary measure has been taken to avoid issues of input output tax adjustments and refunds during 2011-2012.

A 'Record Note' to this effect agreed between the federation and provinces divided GST on services into three broad categories.

Group-I Standalone services; Group-II Telecommunication services; and Group-III Services requiring input/output adjustments.

According to the 'Record Note' on the collection of sales tax on services, Group-I Services included such services that neither involve transactions across the provinces nor constitute a significant proportion as inputs into other supplies.

These services shall be deemed to be of a 'standalone' nature and neither input/output adjustment nor refunds will be provided for services in this group.

Group-I Services may be levied and collected by provincial governments, if they so desire.

Conversely, any province may delegate collection of taxes under Group-I services to FBR.

Group-II includes telecommunication services, given that the origin of these services is clearly identifiable.

The proceeds of GST on telecom services shall be credited directly by telecom companies to the provinces on the basis of revenue generated on the basis of origin of service in each province.

Group-III includes services that constitute a significant proportion as inputs into other supplies or involve transactions across provinces, shall be delegated by the provinces to FBR for collection.

These could include: (i) financial services, including banking, insurance, stock market operations etc; (ii) Advertising services; (iii) construction services; (iv) franchising services; and (v) other services that constitute a significant proportion as inputs into other supplies and involve transactions across provinces.

The 'Record Note' further said that where provinces agree to delegate the power of collection of GST on Services to FBR, collection charges of 1 percent of the net collected amount shall be deducted by the federal government. – *Courtesy Business Recorder*

**2012 PTR 1027 (H.C. Bom.)**

**HIGH COURT OF BOMBAY**

# DR. D.Y. Chandrachud and M.S. Sanklecha, JJ.

***Killick Nixon Limited***
***v.***
***DCIT, Central Circle (3)***

## FACTS/HELD

1. **Transaction within four corners of law can be treated as "sham" & "colourable device" by looking at "human probabilities"**
2. In AY 2000-01 the assessee borrowed Rs. 48 crores from the G. K. Rathi group and used that to buy shares in three 100% subsidiary companies. Though the fair value of the shares was Rs. 24, the assessee paid Rs. 150 for each share. The amount received by the said subsidiary companies was transferred back to another company of the G.K. Rathi group. In AY 2001-02, the said shares were sold for Rs. 5 each and a short-term capital loss was claimed and this was set-off against other long-term capital gains. The AO, CIT (A) & Tribunal (order attached) rejected the transaction ofinvestment into, and sale of, shares as a sham. On appeal by the assessee, HELD dismissing the appeal:

   Whenever there are reasons to believe that the **apparent is not real**; then the taxing authorities are entitled to look into **surrounding circumstances to find out the reality** and apply the test of **human probabilities**. The judgement of the Supreme Court in Vodafone International vs. UOI makes it clear that a **colourable device cannot be a part of tax planning**. Where a transaction is sham and not genuine, it cannot be considered to be a part of tax planning or legitimate avoidance of tax liability. It was clarified that there is noconflict between McDowell 154 ITR 148 (SC), Azadi

Bachao Andolan 263 ITR 706 (SC) & Mathuram Agarwal. On facts, as the purchase and sale of shares was found to be a sham, the loss cannot be allowed (Sumati Dayal 214 ITR 801 (SC) followed)

*Appeal accordingly disposed of.*

**Income Tax Appeal No. 5518 of 2010.**
**Decided on: 6th March, 2012.**
**Present at hearing: Sanjiv M. Shah Advocate for Appellant.** Vimal Gupta Advocate **for Respondent.**

**JUDGMENT**

*Per M.S. Sanklecha, J.–*

This appeal by the assessee under Section 260A of the Income Tax Act, 1961 raises the following questions of law:

i) Whether on the facts and in the circumstances of the case and in law, the Tribunal was in error in confirming the additions projected in questions (ii) to (vi) in infringement of the principles of natural justice and fair play?

ii) Whether on the facts and in the circumstances of the case and in law, the Tribunal was justified in confirming the disallowance of short term and long term capital losses arising out of the sale of shares of Matterhorn Investment Ltd, Mountblanc Investments Ltd, Fircrest Investment Pvt. Ltd. and Galactia Investments Ltd?

iii) Whether on the facts and in the circumstances of the case and in law, the Tribunal was correct in approving the disallowance of short term loss Rs.3,09,26,000/- in connection with the sale of shares of Killick Halco Limited?

iv) Whether on the facts and in the circumstances of the case and in law, the Tribunal was right in affirming the conversion of the above mentioned short term loss Rs. 3,09,26,000/- projected in question no (iii) into a short gain Rs.80,80,540/-?

v) Whether on the facts and in the circumstances of the case and in law, the Tribunal was right in ratifying the disallowance of the long term capital loss Rs. 1,68,37,861/- emanating from the sale of shares of Pelican Paints Ltd?

vi) Whether on the facts and in the circumstances of the case, the Tribunal misdirected itself in law in sanctioning the rejection of the business loss Rs.105 crores emerging from the Appellant's business of providing guarantees? and

vii) Whether on the facts and in the circumstances of the case and in law, the Tribunal's order dated 06.04.2010 is perverse, contrary to weight of evidence adduced by the Appellant and founded on irrelevant considerations and therefore, all its conclusions, findings and holdings are vitiated and plagued by infirmities *inasmuch* as no person acting judicially and properly instructed as to the relevant law would have come to the inferences arrived by the Tribunal insofar as questions (i) to (vi) supra are concerned?

2 Counsel for the Appellant submitted at the out set that the order of the Income Tax Appellate Tribunal dated 6 April 2010 needs to be set aside and the proceedings remanded for fresh consideration, as the Tribunal has relied upon a decision of the Supreme Court in *Sumati Dayal* reported in (1995) 214 ITR 801 (SC) without any party to the proceedings relying upon the same before the Tribunal. Consequently, it is submitted by Counsel that there was a violation of the principles of natural justice. It was submitted that the Appellant would have been able to distinguish the applicability of the decision to the facts of its case.

3 During the course of the hearing, we had suggested to Counsel for the Appellant that since it is settled law that what is recorded in the order of the Court is normally accepted as correct record of what transpired at the hearing, therefore, if the Appellant is of the view that that the impugned order does not reflect the proceedings before the Tribunal correctly then in such a case he may move the Tribunal either by an application for rectification or review. This was particularly in view of the fact that the Appellant was represented by different Counsel before the Tribunal. However, the learned Counsel for the Appellant informed us that he would press this appeal and was not inclined to move the Tribunal by way of application for rectification and/or review.

4 In view of the above, the appeal was taken up for consideration. The facts leading to this appeal are as under:

(a) On 31 October 2001, the Appellant filed its return of income declaring a total loss of Rs.26.87 lakhs for assessment year 2001-02. In its return the Appellant had claimed long term capital gain of Rs.49.72 crores, being the profit earned on the sale of land. This land was sold to Vysya Bank Ltd. to discharge the Appellant's liability as a guarantor for loans advanced by Vysya Bank Ltd. to Geekay Exim (India) Ltd. a company belonging to G. K. Rathi Group. The appropriate authority had issued a certificate on 7 February 2000 under the Urban Land Ceiling Act, granting its no objection to the transfer of the land by the Appellant to Vysya Bank Ltd. The capital gain on the sale of land was set off by a long term capital loss and short term capital loss of Rs.1.45 crores and of Rs.49.73 crores respectively on account of sale of shares. The Assessing Officer doubted the genuineness of the capital loss/gain on account of shares and therefore, *inter alia* called upon the appellant to explain, why the losses on account of shares should not be disallowed, as they appeared to be sham. The Assessing Officer has on investigation of facts, found that during a period of three days from 28 March 2000 to 30 March 2000 the Appellant company which was otherwise a cash starved company, decided to invest a sum of Rs.48 crores in four companies i. e. Matterhorn Investments (P) Ltd., Mountblance Investments (P) ltd., Fircast Investments (P) ltd and Galactia Investments (P) Ltd which were its 100 per cent subsidiaries by subscribing to its shares at a premium. The share held prior to 28 March 2000 and the further purchase of shares at a premium during the period 28 March 200 to 30 March 2000 are as under:

| Sr No. | Name of the party | Amount (including premium of Rs.140) | No. of shares subscripti on (during the F.Y. 1999-2000) | 31.3.92 (100% Holding) | 31.3.90 (100% Holding) | Total holding of Killick Nixon Ltd. | Capital % holding |
|---|---|---|---|---|---|---|---|
| 1 | Matterhorn Investments Pvt. Ltd. | 12.03 Cr. | 800000 | 149998 | 2 | 950000 | 100% |
| 2 | Montblanc Investments Pvt. Ltd. | 12.03 Cr. | 800000 | 149998 | 2 | 950000 | 100% |
| 3 | Fircrest Investment Pvt. Ltd. | 12.03 Cr. | 800000 | 149998 | 2 | 950000 | 100% |
| 4 | Galactica Investment Ltd. | 12.03 Cr. | 800000 | 149998 | 2 | 950000 | 100% |
| | | 48.12 Cr. | | | | | |

This amount of Rs.48/- crores came into the hands of the Appellant company from one G.K.Rathi Group which consisted of the following entities making the following contribution to the Appellant company:

| | | |
|---|---|---|
| 1. | GKAK Rathi HUF | 34.87 crores (28/3 to 30/3) |
| 2. | Subahu Investment Ltd. | 5.50 crores (28/3) |
| 3. | Viplav Trading Ltd. | 1.30 crores (30/3) |
| 4. | Kosha Investments (balances) | 6.325 crores (29/3/00) |
| | | 48.00 crores |

The Assessing Officer also noted the fact that the G. K. Rathi Group was the same person in favour of whose company, the Appellant had given the guarantee to Vysya Bank Ltd. which ultimately led to sale of land to Vysya Bank Ltd. resulting in a capital gain of Rs.49.73 crores to the Appellant. The amount invested by the Appellant in the aforesaid four subsidiary companies viz. Matterhorn Investments (P) Ltd., Mountblance Investments (P) Ltd., Fircast Investments (P) Ltd and Galactia Investments (P) Ltd (hereinafter referred to as the four subsidiary companies) was transferred by the four companies during the period 1 March 2000 to 31 March 200 to a company called Kosha Investments Ltd. which was a part of the G.K. Rathi group.

(b) The amount of Rs.48 crores invested in the four subsidiary companies was invested at a premium of Rs.140/-per share with the face value of the share being Rs.10/-. Therefore, the Appellant purchased shares of all the four subsidiary companies at a price of Rs.150/- per share. The amount raised by the four subsidiary companies were transferred to a company belonging to G. K. Rathi namely Kosha Investments Private Ltd. by 31 March 2000. It was therefore found that the money which came from G.K.Rathi Group amounting to Rs.48 crores during the period from 28 March 2000 to 30 March 2000 was again transferred back to G.K.Rathi Group, as investment, by the four subsidiary companies of the Appellant before 31 March 2000. The four subsidiary companies into which the Appellant had invested at a premium of Rs.140/- per share were valued at less than Rs.23/- per share on price earning capacity and in fact negative when valued on Net Value Basis. The Assessing Officer has recorded in his order that the average price of shares in the four subsidiary companies was less than Rs.25/- per share. Therefore, the investment at a premium of Rs. 140/- per share was found to be inexplicable. When enquired of the reason, why the Appellant invested at such a high premium in the four subsidiary companies, the Appellant informed the Assessing Officer that it was hopeful of the prospects of its four subsidiary companies and therefore invested the amount in those four companies at a premium of Rs.140/- per share. The investment of the four subsidiary companies into Kosha Investment, which was consistently suffering losses from 1997 onwards was only to transfer the funds back to G.K Rathi group. Therefore, the amounts which were received by the Appellant from the G.K.Rathi Group during the period 28 March 2000 to 30 March 2000 were immediately transferred back to G.K. Rathi group as investments into Kosha Investments Pvt. Ltd. In fact the Assessing officer records the following finding:

> "The money never existed. Only debit and credit entries were created in Bank by issuing cheques to one party and receiving the same amount through that party by circular transaction. Thus the Bank accounts got squared up showing no negative balance or positive balance at the end of a particular date on account of the activity."

It is relevant to note that the Director of the four subsidiary companies in his statement stated that the four subsidiary companies decided to issue shares at the direction of the Appellant. The purchase of the shares of the four subsidiary companies as mentioned above was completed during the Assessment year 2000-01 i.e. financial year ending 31 March 2000. Thereafter, in the present assessment year 2001-02 as the Appellant was conscious of the capital gain being made on the sale of land to Vysya Bank Ltd. the shares of all the four subsidiary companies were sold at a loss to one Radha Financial Services Private Ltd. and one Diplomat Trading Private Ltd. The shares of the all the aforesaid companies were sold at a value of Rs.5/- per share to Radha Financial Services Private Ltd. and Diplomat Private Ltd. Consequently, the 1,50,000 shares held since 1992 and earlier when sold at Rs.5/- per share were available to the Appellant as part of its long term capital loss of the present assessment year 2001-02. The sale of 8,00,000 shares in each of the four subsidiary companies of the Appellant at Rs.5/- per share which were acquired during the period 28 March 2000 to 30 March 2000 resulted in a short term capital loss and became part of its short term capital loss for the assessment year 2001-02. The Director of Radha Financial Services Private Ltd. one Shri. Deviprasad Budhiya in his statement before the Income Tax authorities stated that he purchased the shares of the aforesaid four subsidiary companies from the amounts received from T. B. Ruia and Kosha Investments. In his statement he further stated that he gave some of the amounts received by him to Diplomat Trading Private Limited through another concern of his viz. Shree Fiscal Services Private Ltd. In his statement he has stated that he was acting on the instructions of T. B. Ruia, who is the Chairman of the Appellant company and received a consideration of Rs.62,500/- for providing entries. Consequently, the Assessing Officer concluded that not only the purchase of shares of the aforesaid four subsidiary companies was a sham but also the sale of the same to Radha Financial Services Pvt. Ltd. and M/s. Diplomat Trading Private Ltd. which were financed by the Appellant company was also sham and there was no real transaction, so as to create any short term and/or long term Capital loss in respect of the shares of the four subsidiary companies in the hands of the Appellant.

c) The Appellant has also claimed loss on account of sale of shares of Killick Halco Ltd. for the financial year ending 31 March 2001 i. e. the present assessment year 2001-02. The Appellant had on 31 March 2000 converted its loan of Rs.4/- crores to Killick Halco Ltd. into equity shares at the price of Rs.800 per share (including premium of Rs.700/-). This again was exorbitant taking into account the fact that from the assessment year 1996-97 onwards Killick Halco Ltd. was consistently suffering losses. Further, Killick Halco Ltd. had in fact scaled down its operation inasmuch, as it has given VRS to its 86 employees and there was no reason to invest at share premium of Rs.700/- per share in Killick Halco Ltd. This was particularly so as the Assessing Officer had found that the appellant has earlier purchased shares of Killick Halco Ltd. of Rs.19.87 per share in November 1999 i. e. in the Assessment year 2000-01 and therefore, the price of Rs.800/- (including a premium of Rs.700/-) per share in March 2000 i. e. also in the Assessment year 2000-01 was not justifiable at all. This purchase of shares by converting loan into equities was only done, as the Appellant company was aware of the forthcoming capital gain on sale of land in the next Assessment year i. e. 2001-02. Therefore it was found that the Appellant wanted to create an artificial loss in the next Assessment year so as to reduce the amount of tax payable on account of capital gain. The Assessing Officer enquired from the Appellant company the reasons for investment in Killick Halco Ltd. at the premium of Rs.700/- per share. The reason offered by the Appellant was that they expected revival in the fortune of Killick Halco Pvt. Ltd. in the near future. The Appellant thereafter in the present Assessment year i. e. 2001-02 sold the shares of Killick Halco Ltd. at a price of Rs.83/- per share by selling it to its group company viz. Snowcem India Ltd. The purchase of 50,000 shares was at exorbitant price of Rs.800/- per share and the sale of the share to a group company at a price of Rs.83/- per share enabled the Appellant to show a short term capital loss in respect of Killick Halco Ltd. of Rs.3.09 crores i. e. costs of acquisition of 50,000 shares at Rs.800/-(on conversion of debt into equity) and 78,000 shares at Rs.19.87 per share purchased in November 1999 became a part of short term capital loss of Rs.49.49 crores. While 2,20,000 equity shares held from a period prior to 1981 were also sold at a loss as a part of its long term capital loss of Rs.1.45 crores. The Assessing officer held that as the shares of Killick Halco Ltd. were sold to a group company, the Appellant continued to have control over it . Therefore the investment in Killick Halco ltd. and its subsequent sale were only seen as a vehicle for booking losses adopted by the Appellant. Therefore in the aforesaid facts the Assessing officer held that purchase (conversion of debt into equity ) of 50,000 shares at Rs.800/- per share were sham and not bonafide and therefore disallowed the short term loss on the above account. However the Assessing Officer treated the investment of 78,000 shares at Rs.19. 97 per share as genuine and allowed the short term capital loss with regard thereto.

d) The Appellant has also claimed long term capital loss of Rs. 1.68 crores on sale of its shares in Pelican Paints Ltd. to Snowcem India Ltd. (company belonging to the same group). The Appellant had purchased the shares in financial years 1998-99 and 1999-2000 at Rs.518/- and Rs. 365/- respectively in Pelican Paints Ltd. These shares were sold to Snowcem India Ltd. at a nominal price of Rs.10/- per share during the present year. However, while arriving at the true and fair value of Pelican Paints ltd. the Appellant company failed to take in to account the land and buildings of Pelican Paints ltd. Further it was found that the whole amount was settled by current account adjustment between Snowcem India Ltd. and the Appellant. Consequently, the Assessing Officer concluded that the sale was a sham and was self serving so as to create long term capital losses.

(e) The aforesaid findings of fact have been arrived at by the Assessing officer by his Order dated 29 March 2004 after considering the evidence. The Order dated 29 March 2004 was affirmed by the Order dated 25 November 2004 of the C.I.T. (Appeals) and further confirmed by the Order dated 6 April 2010 of the Tribunal.

(f) Before the CIT (Appeal) the Appellant urged a new ground of appeal which was as under:

> "The learned Deputy Commissioner of Income tax ought to have allowed the entire amount of consideration determined on acquisition of land by Vysya Bank ltd. as business loss incurred by the Appellant in the course of carrying on of business of providing guarantees."

5 It was the case of the Appellant that they have executed a letter of guarantee to the extent of Rs.100/- crores in favour of Vysya Bank Ltd. Mumbai for consideration of the bank extending financial facilities to Geekay Exim (India) Ltd., a company belonging to G. K. Rathi Group. At that time in 1996 an agreement was entered into between Geekay Exim India Ltd. and the Appellant company inter alia providing that Geekay Exim India Ltd. would indemnify the Appellant company against all actions and proceedings that may be made by Vysya Bank Ltd. in connection with letter of guarantee executed by the Appellant company in favour of Vysya Bank Ltd. In consideration of the above guarantee, it was agreed that Geekay Exim India Ltd. shall deposit and keep deposited with the Appellant at all times a sum of 10% of the facilities sanctioned by Vysya Bank Ltd. to Geekay Exim India Ltd. on the basis of the guarantee. It was also agreed that Geekay Exim India Ltd. will pay to the Appellant 2% of its gross realization of export proceeds as commission to the Appellant in consideration of the Appellant guaranteeing facilities extended by Vysya Bank Ltd. Subsequently, Geekay Exim India Ltd.

failed to repay its loan to Vysya Bank Ltd. and the bank decided to execute the bank guarantee provided by the Appellant. Consequently, an agreement was entered into in September 1999 by which the Appellant company agreed to transfer its land to Vysya Bank Ltd. for a consideration of Rs.105/- Crores which was to be adjusted against the financial facilities provided to Geekay Exim India Ltd. The Appellant company was claiming a loss of Rs.105/- crores having arisen in the guarantee business. This ground was taken by the Appellant for the first time before the CIT (Appeal). The Appellant contended before the CIT (Appeal) that the guarantee was extended by them during the regular course of business and consequently, there was loss of Rs.105/- crores.

6 The CIT (Appeal) concluded that the Appellant did not carry out the activity of providing guarantee to Vysya Bank Ltd. in the normal course of its business. Further, it was held that the Appellant company which is following mercantile system of accounting had never accounted for the commission income in its return of income filed after entering into contract with Geekay Exim India Ltd. till the present assessment year when it has shown an income of Rs.6/- crores in respect of the guarantee business as pertaining to prior years in its account. The CIT (Appeal) concluded that the business was not genuine, as if it had been genuine then Appellant company would have provided guarantee commission income in the course of its regular course of business. The CIT (Appeal) also held that the Appellant was entitled to receive 2% of the gross export realization of Geekay Exim India Ltd. but till date the Appellant never received a rupee on that account and neither did it pursue the recovery of the same. It was concluded that no prudent business man would risk his land worth Rs.105/- crores without ascertaining the returns to be received. The CIT (Appeal) concluded that G.K.Rathi Group was shown as debtors in the Appellant's books of account but the amount was neither treated as doubtful nor written off. In view of the above, CIT(Appeal) concluded that providing of guarantee to Vysya Bank Ltd. was not in the normal course of Appellant's business and the resulting loss could not be allowed as a trading/business loss.

7 The aforesaid finding of the CIT (Appeal) was upheld by the Tribunal in its Order dated 6 April 2010.The Tribunal concluded that the loss itself was not genuine and therefore, the same cannot be allowed as deduction. The Tribunal inter alia held that though the Memorandum of Association of the Appellant company did in its object clause provide for doing the business of giving guarantees, the Appellant had not once in the last 50 years of its existence issued any guarantee and taking into account the over all relations between G.K. Rathi Group and the Appellant company, the loss on account of guarantee was not considered to be a genuine business activity.

8 The Tribunal in the impugned Order held that though the amounts on account of Guarantee commission were accounted in the assessment

year 2000-01 they were never received by the Appellant and there is nothing on record to show that any attempt was made to recover the same. The Tribunal confirmed the finding of the CIT(A) that the Appellant company never bothered to find out why Geekay Exim (India) Ltd. failed to pay the amounts to Vysya Bank Ltd. The Tribunal observed as a fact that when the Appellant wanted to invest in its subsidiary companies funds were organized to the extent of Rs.40 crores from G.K. Rathi group which also consist of Geekay Exim (India) Ltd. Therefore the Tribunal wondered that why the above amounts could not be recovered by the Appellant from G.K. Rathi Group or its group company Geekay Exim (India) Ltd. Thus, according to the Tribunal the loss was a make believe story which is different from reality.

9 The submissions of the Counsel are being considered by us while dealing with the questions of law raised in the appeal.

10 So far as, question No.(i) referred to above is concerned, it is contended by the Counsel for the Appellant that the Tribunal had while examining the evidence before it in respect of all issues, chosen to rely upon the position in law laid down by the Supreme Court in the matter of Sumati Dayal (supra) to the effect that the evidence produced must be analyzed by applying the theory of surrounding circumstances and human probabilities. However it is the grievance of the Advocate for the Appellant that before placing reliance upon it, the Tribunal ought to have given notice of the same to the parties as that would enable the parties to make submissions on the same and demonstrate as to how it is inapplicable or distinguishable from the present facts. Counsel for the Respondent stated that the test of applying surrounding circumstances and human probabilities is a well known and accepted manner of weighing evidence in all civil matters to decide whether the claim is genuine or not and submitted that assuming without admitting that the same was not cited and/or referred to during the course of the hearing no prejudice has been caused to the Appellant.

11 To our mind, the test laid down by the Supreme Court in the decision in Sumati Dayal is well a settled test which is applied in all civil proceedings particularly, with regard to testing the genuineness of a transaction. In fact the CIT (Appeals) has also applied the same test to reach the conclusion that the transactions claiming a Capital loss on account of sale of shares were not genuine. Counsel for the Appellant submitted that the Tribunal by referring to the decision of the Supreme Court in *Sumati Dayal* (supra), was in breach of the proviso to Rule 11 of the Income Tax Appellate Tribunal Rules, 1963. Rule 11 of the Income Tax Tribunal Rules reads as under :

> "The Appellant shall not, except by leave of the Tribunal, urge or be heard in support of any ground not set forth in the memorandum of appeal, but the Tribunal, in deciding the appeal, shall not be confined to the grounds set forth in the

memorandum of appeal or taken by leave of the Tribunal under this rule:

> **Provided** that the Tribunal shall not rest its decision on any other ground unless the party who may be affected thereby has had a sufficient opportunity of being heard on that ground."

The proviso to the Rule 11 would have no application to the present facts, as the Tribunal has not based its decision on a ground which had not been urged by the parties before it. The decision of the Supreme Court supports a statement of a well settled position in law. Counsel for the Appellant thereafter relied upon a decision of this Court in *Inventure Growth vs. ITAT* reported in 324 ITR 319 to submit that in similar facts, this Court set aside the order of the Tribunal. In Inventure Growth and Securities Ltd. (supra) a petition under Article 226 of the Constitution of India had been filed challenging an order of the Tribunal passed on a rectification application filed by the party. The Tribunal had disposed of the appeal on merits by relying upon another decision of the Tribunal, without furnishing an opportunity of hearing to the party to deal with the decision. Consequent thereto, the party in the above case filed a rectification application before the Tribunal under Section 254(2) and sought to bring on record the fact that the decision of the co-ordinate bench on merits of the matter was not available to the party as it had not been published in a law journal at the date of the hearing and consequently they were not in a position to deal with the same. The Tribunal by its order dated 20 November 2009 dismissed the rectification application after recording the fact that the decision of the coordinate Bench of the Tribunal was not placed before the Tribunal either by the assessee or by the Revenue and the Tribunal decided to follow it on its own. It was in the aforesaid facts that this Court allowed the Misc. Application and restored the appeal before the Tribunal for reconsideration. However, while doing so, the Court clarified that "It cannot be laid down as un-flexible proposition of law that an Order of remand on a miscellaneous application under Section 254(2) would be warranted merely because the Tribunal relied upon a judgment which was not cited by either party before it.". In the present facts, the decision of the Supreme Court in Sumati Dayal (supra) was cited only for the purpose of reiterating the well settled/established position of law. Surrounding circumstances and human probabilities are to be taken into account while considering the evidence produced before the Tribunal to examine the genuineness of the case. Counsel for the Appellant also relied upon a decision of this court in *CIT vs. Jamnadevi Agarwal* reported in 328 ITR 656 to contend that this Court has not applied the decision of the Supreme Court in the matter of Sumati Dayal (supra) in the above case as the documentary evidence produced before the authorities, conclusively proved that there was no question of introducing unaccounted money, as the transaction of sales took place at the rates prevailing on that date in the stock market. The aforesaid decision in the matter of Jamnadevi (supra) proceeded on its own facts and the decision of the Supreme Court was held to be inapplicable in the factual context existing in that case. However, the decision of the Supreme Court in the matter of Sumati Dayal (supra) would be applicable, when ever there are reasons to believe that the apparent is not real; then the taxing authorities are entitled to look into surrounding circumstances to find out the reality by looking at the surrounding circumstance and applying the test of human probabilities. A reference to the decision in Sumati Dayal's case on a principle of law cannot be said to have caused prejudice to the Appellant. This conclusion is based while proceeding on an assumption that the aforesaid decision of the Supreme Court was not cited and/or referred to during the course of the hearing leading to the order dated 6 April 2010. In view of the above, no substantial question as framed at (i) above arises in the present case.

12. So far as questions No. (ii) to (vii) are concerned, Counsel for the Appellant did not separately address on each question of law but submitted that as the Tribunal was guided by the decision of the Supreme Court in *Sumati Dayal* (supra) that led to a miscarriage of justice leading to a substantial question of law. As pointed out hereinabove, while disposing of question No.(i) raised by the Appellant, the Tribunal merely records a well settled position of law and in the course of recording the same, referred to the decision of the Supreme Court in the matter of Sumati Dayal (supra) and same test had been applied by CIT(Appeal) without referring to the decision. Counsel for the Appellant relied upon the decision of the Supreme Court in *Omar Salay Mohamed Sait* reported in 1959(37) ITR 372 to contend that where the findings of the Tribunal are based on suspicion, conjectures or surmise or on no evidence then even if they are questions of fact they are liable to be set aside. Counsel for the Appellant further submitted that in the present case the shares had in fact been purchased and transferred and all documents were on record to establish to purchase and sale of shares. Consequently, there is no reason to deny the benefit of loss on account of capital gain on account of sale of shares. So far as Question No. (vi) is concerned, Counsel for the Appellant urged that the tribunal was incorrect in holding that there could be no loss on guarantee business as the Appellant had not done a single transaction prior to the present transaction. It was submitted that even a single transaction could constitute business for the purposes of the Income Tax Act. Counsel for the Appellant further submitted that on facts the Tribunal had for the earlier year i.e. Assessment year 2000-01 assessed Rs. 6/- crore as business income and therefore the loss in the current year should have been allowed. Counsel further contends that the Tribunal erred in holding that there is nothing on record to show that the Appellant had tried to recover the money ignoring the fact that the Order itself notes that a copy of the suit was produced during the course of the hearing.

Counsel for the Respondent contended that there are concurrent findings of fact of three authorities and the Appeal should not be entertained.

13 We have considered the submissions of the Counsel for the Appellant and the Respondent in respect of Question No. (ii) to (vii).

14 So far as the principle laid down in the matter of Omar Salay Mohamed Sait (supra) is concerned there can be no dispute about the proposition laid down therein. However we have not been shown how the Tribunal was in breach of the same. We find that the Tribunal has considered the evidence of purchase and sale of shares to book long term and short term losses and taking all the evidence together including the surrounding circumstances reached a finding that the purchase and sale of shares is not genuine. So far as the decision of the Supreme Court in *Vodafone International* (dated 20 January 2012) is concerned, the Court considered its decisions in the matters of *McDowell* reported in (1985) 3 SCC 230, *Azadi Bachao* reported in (2004) 10 SCC 1 and the *Mathuram Agarwal* reported in (1999) 8 SCC 667 and concluded that where the transaction is not genuine but a colourable device there could be no question of tax planning. The Supreme Court in the aforesaid case after considering the aforesaid two decisions concluded as follows:

> "The majority judgment in McDowell held that "tax planning may be legitimate provided it is within the framework of law" (para-45). In the latter part of para 45, it held that "colourable device cannot be a part of tax planning and it is wrong to encourage the belief that it is honourable to avoid payment of tax by resorting to dubious methods". It is the obligation of every citizen to pay the taxes without resorting to subterfuges. The above observations should be read with para 46 where the majority holds "on this aspect one of us, Chinappa Reddy, J. has proposed a separate opinion with which we agree".The words "this aspect" express the majority's agreement with the judgment of Reddy, J. only in relation to tax evasion through the use of colourable devices and by resorting to dubious methods and subterfuges. Thus, it cannot be said that all tax planning is illegal/illegitimate/impermissible. Moreover, Reddy, J. himself says that he agrees with the majority. In the judgment of Reddy, J. there are repeated references to schemes and devices in contradistinction to "legitimate avoidance of tax liability (Paras 7-10, 17 and 18). In our view, although Chinnappa Reddy, J. makes a number of observations regarding the need to depart from the "Westminster" and tax avoidance-these are clearly only in the context of artificial and colourable devices. Reading McDowell, in the manner indicated hereinabove, in cases of treaty shopping and/or tax avoidance, there is no conflict between McDowell and Azadi Bachao or between Mcdowell and Mathuram Agarwal."

15 The aforesaid observations of the Supreme Court makes it very clear that a colourable device cannot be a part of tax planning. Therefore where a transaction is sham and not genuine as in the present case then it cannot be considered to be a part of tax planning or legitimate avoidance of tax liability. The Supreme Court in fact concluded that there is no conflict between its decisions in the matter of *McDowell* (supra), *Azadi Bachao* (supra) and *Mathuram Agarwal* (supra). In the present case the purchase and sale of shares, so as to take long term and short term capital loss was found as a matter of fact by all the three authorities to be a sham. Therefore authorities came to a finding that the same was not genuine. So far as the question Nos.(ii), (iii) (iv) and (v) are concerned, we hold that these are pure questions of facts and as there are concurrent finding of the authorities below, no question of law arises for this Court to interfere.

16 So far as Question No.(vi) is concerned, the issue of guarantee loss was raised for the first time in appeal before CIT (Appeal) and both the CIT (Appeal) and the Tribunal also found that the claim for loss is not genuine. However, the Appellant is correct in contending that even a single transaction could be in the nature of trade. However, on examination of surrounding circumstances and the parties involved viz. the G.K. Rathi group and its close relationship with the Appellant, it was concluded that the transaction was not genuine. The Tribunal is entitled to look at the surrounding circumstances and to human probabilities to test the evidence led before it. However, while testing the evidence the Tribunal must correctly look at all the evidence and the surrounding circumstances to decide the issue. We find that the Tribunal has considered the fact that for the earlier year Rs.6/- crores was assessed to tax but held that there is no evidence to show that any attempt was made to recover the amounts from Geekay Exim (India) ltd. when in fact evidence was placed before the Tribunal by the Appellant of suits being filed by the Appellant against Geekay Exim (India) Ltd. However what is the nature of suits and for what amounts etc is something which has not been examined. The Tribunal in its order amongst other factors has also taken into account the fact that ever since 1947 when the Appellant company was incorporated it had never issued any Guarantee and therefore, the deduction of business loss of Rs. 105/- crores for providing guarantees by the CIT (Appeal) was upheld by the Tribunal. To our mind, the fact that the Appellant did not do the business of providing guarantees earlier will not prohibit the assessee from providing guarantees during the relevant assessment year. The Memorandum of Association of the Appellant company does provide as one of its objects for providing guarantees in respect of loans advanced to other parties. There were other reasons for which the Tribunal and the CIT did not accept the business loss of Rs.105/- crores emerging from the Appellant's business from providing guarantees. The surrounding circumstances can be looked at, but not without considering the evidence led by the party in support of

its stand. In this case, the Tribunal has not considered the evidence of suit etc. being filed by the Appellant before rejecting its claim for loss only on the basis of surrounding circumstances. In view of the above, so far as the question No.(vi) is concerned, it would be proper to remand the matter to the Tribunal to reconsider the issue and pass an appropriate orders thereon.

17. So far as the Question No.(vii) is concerned, we are of the view the same does not arise as all the authorities including the Tribunal have considered all the evidence produced before them and on appreciation of facts have come to a conclusion which is a possible conclusion. Therefore, question No.(vii) also does not arise.

18 In view of the aforesaid reasons, the order of the Tribunal dated 6 April, 2010 is set aside only to the extent that the business loss of Rs.105/- crores on account of the business of giving guarantees claimed by the Appellant has been rejected. The Tribunal shall hear the Appellant and the Respondent to decide afresh on the issue.

19 The Appeal is, accordingly, disposed of. No order as to costs.