IN THE INCOME TAX APPELLATE TRIBUNAL AT AHMEDABAD
AHMEDABAD "A" BENCH
(BEFORE S/SHRI R.V.EASWAR, VICE-PRESIDENT AND
N.S. SAINI, ACCOUNTANT MEMBER)

ITA.No.998 and 999/Ahd/2007
[Asstt.Year : 2000-2001 and 2001-2002]

Tushti Securities Pvt. Ltd. 8-Sripath Society St.Xavier's School Road Navrangpura, Ahmedabad.	Vs.	ACIT, Cir.3 Ahmedabad.

ITA.No.1052/Ahd/2007
[Asstt.Year : 2000-2001]

ACIT, Cir.3 Ahmedabad.	Vs.	Tushti Securities Pvt. Ltd. 8-Sripath Society St.Xavier's School Road Navrangpura, Ahmedabad.

Assessee by	:	Shri S.N.Soparkar
Revenue by	:	Shri Govind Singhal

O R D E R

PER R.V.EASWAR, VICE-PRESIDENT: These appeals relate to the same assessee and were heard together. Accordingly, they are disposed of by a single order. In respect of the assessment year 2000-2001, both the assessee and the department are in appeal. For the assessment year 2001-2002, the appeal is by the assessee. The assessee is a private limited company engaged in the business of share broking. All the three appeals relate to penalties imposed on it under Section 271(1)(c) of the Income Tax Act.

2. We may notice the facts giving rise to the appeals in brief. In respect of the assessment year 2000-2001, while completing the assessment under Section 143(3), the Assessing Officer (AO) disallowed the jobbing loss of Rs.17,35,790/- and another sum of Rs.14,17,888/- as diversion of income in the name of income excess brokerage paid back. Thus, the total amount disallowed and added back on account of the aforesaid two items came to

Rs.31,53,678/- . In respect of the jobbing loss, it was the view of the AO that it was a loss arising out of speculative business and cannot be claimed to be set of against the brokerage and interest income. For this purpose, he relied on the fact that in the assessment years 1997-98 and 1998-1999, the CIT(A) had held that the transactions entered into by the assessee in shares were speculative transaction since no physical delivery of the shares was involved and therefore the jobbing loss claimed against the brokerage income cannot be allowed. In respect of the addition made for "diversion of income in the name of excess brokerage paid back", the AO observed that the assessee's claim that it paid back the brokerage charged from selected clients on account of the volume of business given by them was not substantiated by the assessee. He noticed that the expenses were debited to the *sauda* brokerage account but the corresponding credits were not given to the parties' accounts. He also noted that the assessee had charged brokerage from all the clients regardless of the volume of activity, whereas the same has been returned only to some persons. The AO further noted that different terminologies were used by the assessee to describe the debits in the *sauda* brokerage accounts. From these observations he drew the inference that the assessee was attempting to divert its income to some selected persons and therefore called upon the assessee to explain why it should not be added back to the income. The assessee responded by submitting that (a) the parties to whom the brokerage was returned were not related to the assessee, (b) the excess brokerage was returned to them as incentive for introducing new clients and as reimbursement of expenses such as conveyance, refreshments etc. and in some cases as even remuneration for helping out in the routine office work, (c) the assessee was charging a uniform rate of commission from all the clients but later on a part of the commission was returned to clients with high volumes and regular transactions and to some of them as incentive for introducing new clients, (d) that the assessee was following the somewhat raw system of deciding about who should be refunded

a part of the brokerage and how to account for the same and that these were decided on ad hoc basis by the directors on requests from the clients and (e) the different narrations used in respect of the debit entries were the accountant's doing and also because of limitation in the software and in such circumstances AO's inference that the assessee tried to divert its income in the guise of return of a part of the brokerage was not justified. These submissions were not accepted by the AO who examined them in detail in paras-3.3 and 3.4 of the assessment order. The gist of the findings is; (a) the assessee has been selective in returning the brokerage to some persons only, though a uniform brokerage has been charged from all of them, (b) there is no basis given for calculating the excess brokerage paid back and they are in round figures, without any rate or basis being mentioned, (c) sometimes, the refund of the brokerage has been made in cash, (d) the return of the excess brokerage should have been done at the end of the vallan period but the assessee has debited the same in the very first day of vallan on many occasions, (e) the return of the brokerage has not been debited to the accounts of the clients but they are debited in the final JV account, (f) no names and addresses or other details of the new clients supposed to have been introduced by the clients to whom part of the brokerage was refunded were furnished and no detailed accounts were maintained for such incentives and (g) the assessee's claim that part of the amount refunded included reimbursement of expenses cannot be accepted as correct because such expenses would have been debited to the respective accounts already maintained by the assessee such as conveyance, tea and coffee expenses, etc. On the basis of these findings the AO held that the assessee was unable to discharge its onus to prove that the debits in the *sauda* brokerage account did not amount to diversion of income to avoid tax. In para-3.4 of the assessment order he gave the computation of the income sought to be diverted, which came to Rs.14,17,888/- and disallowed the same in the assessment order.

3. The assessee carried the matter in appeal to the CIT(A) who confirmed both the additions. A further appeal was taken to the Tribunal in ITA No.80/Ahd/2005.

4. In the assessment year 2001-2002, a similar disallowance of the jobbing loss of Rs.18,20,040/- for the same reasons as were stated in the assessment year 2000-2001 was made as also the addition of Rs.2,05,920/- in respect of excess brokerage returned. This addition was also made for the same reasons as in the assessment year 2000-2001. The AO also disallowed Rs.11,098/- being the amount paid to the Ahmedabad Stock Exchange which he considered to be in the nature of penalty. Against these additions, the assessee filed an appeal to the CIT(A) who confirmed the disallowance of the jobbing loss and the excess brokerage paid back and deleted the disallowance of the amount paid to ASE. The assessee carried the matter in appeal to the Tribunal in ITA No.104/Ahd/ 2005.

5. Both the appeals filed by the assessee were heard and disposed of by common order dated 28-11-2008 by the Tribunal. So far as the jobbing loss is concerned, the Tribunal noticed that in the assessment years 1996-97 and 1998-99 the Tribunal has by order dated 31-7-2006 in ITA Nos.856 and 853/Ahd/2001 restored the issue to the file of the AO to examine the assessee's claim that proviso (c) to section 43(5) applies to its case, since the jobbing transactions were carried out to guard itself against the loss which may arise in the ordinary course of business of the assessee. Following this order, the Tribunal in its order for the years now under appeal, restored the issue of the jobbing loss to the AO for fresh consideration.

6. As regards the disallowance on account of diversion of income by returning the excess brokerage paid by the clients the Tribunal dealt with this issue in its order cited supra in para-5.1 to 9 of its order dated 28-11-2008.

After quoting elaborately from the order of the CIT(A) for the assessment year 2000-2001 and after briefly noticing the arguments of both the sides in para-7 and 8, the Tribunal recorded its finding in para-9 as under:

> *"9. Having heard rival submissions, facts and circumstances and various documents placed on PB to which our attention was drawn, and the decision of the Supreme Court in the case of S.A.Builders (supra), we are of the opinion that CIT(A) has dealt with the issue in details and the assessee has not brought any evidence to our notice contrary to the findings of the CIT(A) which are on appreciation of facts as well as consideration of legal provisions relating to Section 37(1) of the Act, and therefore, we do find any infirmity in the orders of the CIT(A) on this point for both the assessment years. So far as assessee's plea of business exigency is concerned, we are of the opinion that the assessee has not brought to our notice any evidence, which could establish that the expenditure incurred by the assessee was on account of business expenditure, the assessee plea is not sustainable on facts of the case and therefore the same is rejected."*

Thus the Tribunal confirmed the disallowance made by the AO under the head "diversion of income in the name of excess brokerage paid back" for both the years.

7. In the penalty proceedings initiated by the AO under Section 271(1)(c) of the Act for concealment of the income, the AO has strongly relied on *Explanation* I to section 271(1)(c) of the Act and has held that (a) the assessee has deliberately indulged in an accounting fraud to reduce its taxable income by claiming expenses not incurred, (b) the assessee has failed to substantiate the payment of brokerage back to the clients, (c) any such payment made to the client is illegal and contrary to SEBI Act, (d) there was a conscious effort by the assessee to camouflage its accounts by not maintaining proper accounts and in these circumstances the assessee is guilty of concealment of income. Accordingly he imposed a penalty of Rs.12,14,166/- for the assessment year 2000-2001 and Rs.98,841/- for the assessment year 2001-2002. It is seen that

for the assessment year 2001-2002, the AO did not levy penalty in respect of the disallowance of the jobbing loss of Rs.18,20,040/-.

8. In respect of the assessment year 2000-2001, the CIT(A) by order dated 12-12-2006 in the appeal against the penalty held that the claim of jobbing loss will not amount to concealment of income or furnishing inaccurate particulars thereof and accordingly cancelled the penalty. He however sustained the penalty imposed in respect of the disallowance of the excess brokerage paid back. According to him the assessee has not filed any evidence to substantiate its explanation for paying back the brokerage to its clients, either before the AO or before him. He also held that the assessee did not file any details showing the number of new clients introduced by the existing clients to justify the return of the brokerage as incentive. According to the CIT(A) the assessee was unable to adduce any evidence in support of its explanation. He further held that the AO has found that the assessee's claim regarding return of brokerage to persons doing high value transactions was not correct and the maintenance of the accounts was also defective. For all these reasons he sustained the penalty imposed with reference to the disallowance of the excess brokerage paid back and allowed the assesee's appeal in part. Whereas the assessee has come in appeal before the Tribunal in ITA No.998/Ahd/2007 questioning the levy of penalty with reference to the excess brokerage payment, the department has come in appeal raising the following grounds in ITA No.1052/Ahd/2007:

> *"1. The CIT(A) has erred in law and on facts in directing to re-compute the penalty considering the excess brokerage paid back amounting to Rs.14,17,888/- as concealed income and not on the total addition of Rs.31,53,678/-"*

9. In respect of the assessment year 2001-2002, the CIT(A) following his order for the assessment year 2000-2001 sustained the levy of penalty with reference to the disallowance of the brokerage repayment of Rs.2,05,920/- and

dismissed the appeal. The assessee is in further appeal before the Tribunal in ITA No.999/Ahd/2007.

10. In support of the assessee's appeals it was argued on its behalf that full justification for the return of the brokerage charged from the clients was given vide assessee's letter dated 17-3-2003 to the AO, a copy of which is placed at pages 18 and 19 of the paper book and it was also pointed out that confirmations from eight parties were filed along with the letter and the confirmations from six parties were filed under cover of the letter dated 19-3-2003 addressed to the AO, copies of which are pages 28 to 34 of the paper book. It would appear that there was some confusion as to whether the first set of eight confirmations were filed along with the letter dated 17-3-2003 and in order to clear the same those confirmations were filed with the AO under cover of letter dated 31-3-2003 (pages 35 and 36 of the paper book). It was argued by the learned counsel for the assessee that in the light of the above factual position, the finding of the CIT(A) and the Tribunal in the assessment proceedings that the assessee did not furnish the relevant details of the brokerage refund does not have much force and since this finding is the basis for the penalty proceedings, especially for invoking *Explanation* 1 to section 271(1)(c), the entire penalty proceedings fall to the ground. It was further submitted that it is one thing to make disallowances and additions in the assessment order for lack of information from the assessee, but that alone would not suffice in the penalty proceedings. In this connection, it was contended that there is no evidence in this case to show that whatever was claimed to have been returned to the clients out of the brokerage charged from them, ultimately found its way back to the assessee and in the absence of a finding to that effect there is no basis for the conclusion that the assessee concealed its income or furnished inaccurate particulars thereof. Another argument advanced by the learned counsel of the assessee was that the complete names and addresses of fourteen clients, to whom part of the

brokerage was returned were given in the confirmation letters filed with the AO and if he doubted the confirmations it was open to him to issue summons and examine those persons to verify the truth of the assessee's version. Our attention was drawn to the decision of the Special Bench, Ahmedabad in Gujarat Credit Corporation Ltd. Vs. ACIT, (2008) 113 ITD 133 (Ahd) (SB) where the true meaning and impact of *Explanation* 1 was expounded. Reliance was also placed on the order of the Third Member, Delhi Bench in the case of ACIT Vs. Premchand Garg, (2009) 123 TTJ 433 (Del) (TM) in which case also the true meaning and purpose of *Explanation* 1 was explained. Relying on these decisions, it was submitted that the assessee's explanation has to be found to be false in order that the *Explanation* 1 below section 271(1)(c) can be successfully invoked. Reliance is also placed on the following judgments of the Hon'ble Gujarat High Court:

a) National Textiles Vs. CIT, (2001) 249 ITR 125 where it was held that unless the assessee's explanation was false, no penalty can be imposed by invoking *Explanation* 1 if the facts and circumstances were equally consistent with the explanation offered by the assessee, and

b) Sarabhai Chemicals Pvt. Ltd. Vs. CIT, (2002) 257 ITR 355 where it was held that the deeming fiction contained in *Explanation* 1 will not apply if the explanation given by the assessee in the assessment proceedings which he could not substantiate in those proceedings was *bona fide* and if the disclosure was full and all facts material to the computation of the income have been disclosed;

It was accordingly contended by the assessee that the penalty imposed is unjustified.

11. The learned Sr.DR appearing for the department, on the other hand, contended that *Explanation* 1 to section 271(1)(c) was fully applicable to the case because the assessee's explanation regarding the return of the brokerage payment was found incorrect or wrong and it was also not possible for the AO

to issue summons in the absence of complete address of the clients to whom part of the brokerage was refunded. Our attention was drawn to the confirmation letters filed in the paper book and it was pointed out that the addresses given therein were vague and it was not possible to issue summons to such vague addresses. The learned Sr.DR also contended that despite opportunity the assessee was unable to specify the mode of payment of the brokerage and it was merely stated that there were debit entries in the *sauda* brokerage accounts which hardly justify the assessee's claim that full details relating to the claim were furnished to the AO. He further contended that the assessee did not also furnish the details of the new clients introduced by the existing clients, which was a crucial fact, in order to justify the repayment of the brokerage charged from the latter. The assessee's explanation was not *bona fide* and was not supported by any evidence. It was also submitted that the claim made by the assessee regarding return of the brokerage charged from the clients was contrary to the provisions of section 12, SEBI Act. Strong reliance was placed on the finding of the Tribunal in the assessee's appeals in the assessment proceedings and it was submitted that the findings of the Tribunal supported the levy of penalty. It was thus submitted that the penalty was rightly confirmed by the CIT(A) for both the years.

12. We have carefully considered the rival submissions and the facts of the case. The assessee's appeals are directed against the penalty sustained by the CIT(A) in respect of the repayment of the brokerage charged from the clients. In our opinion, the penalty was rightly levied. This is a case where it appears to us that *Explanation* 1 to section 271(1)(c) of the Act has been rightly invoked by the Assessing Officer. Under this *Explanation* an assessee would be deemed to have concealed the particulars of his income if, in respect of facts material to the computation of his income, he fails to offer an explanation or offers a false explanation or an explanation which he is not able to substantiate and also fails to prove that his explanation was *bona fide*. We are of the view

that the assessee in the present case has offered an explanation which he was not able to substantiate and also failed to prove that the explanation was *bona fide*. The assessee has also not disclosed all the facts relevant to the explanation and material to the computation of his income. Clause (B) of *Explanation* 1 is attracted to the case. When called upon to prove the repayment of the brokerage to a few selected clients, fourteen in number, the assessee was under duty to comply with all the queries raised in the questionnaire issued by the AO. Theoretically the assessee has tried to explain the questions raised by the AO. However, the assessee has not been able to furnish the precise addresses of the fourteen parties so that summons could be issued to them to verify the correctness of the claim. For example, some of the addresses are (a) Nitan Raval, Sharda Society, Nr.Sharda Mandir, Paldi, Ahmedabad, (b) Pallavi Soni, Dayabhai Park, Maninagar, Ahmedabad, (c) Vikram Nagar, G/8, Sushmita Flat, Vasna, Ahmedabad, (d) Vandanaben Shah, Dhanlaxmi Society, Maninagar, Ahmedabad etc. No doubt, there are few confirmations which contained slightly more precise addresses. However, that does not take the matter further because the assessee has not been able to meet the queries raised by the AO accurately. It has not been able to give details of how much business each client had with it and what was the number of new clients introduced by them so as to justify return of the brokerage charged from them in part. It was the duty of the assessee to show with exact figures the basis of calculating the amount of brokerage to be returned to the existing clients. In fact the assessee itself stated in its letter dated 17-3-2003 that it was having a somewhat raw system of deciding and accounting such claims and that these claims were decided on ad hoc basis by the director upon the request from the clients. The AO also called upon the assessee to show how much brokerage have been charged from the clients, as it was not clear from the *sauda* account, but this query also remained un-complied with. Further, in the questionnaire the AO had also stated that the assessee did not apply any

"required criteria to return back the brokerage" and the reply of the assessee was that such claims were decided on ad hoc basis by the director upon request from the clients. Even allowing for full play of the principle that it is for the businessman to decide how he will conduct his business, the assessee's reply is too vague to be considered seriously. The assessee has stated that the brokerage returned not only included incentives but also reimbursement of certain expenses, such as conveyance, tea, coffee etc. and in some cases also included remuneration for helping out in the routine office work. This explanation rings hollow and the assessee made no attempt to furnish the full facts and figures to support his claim. There was no attempt to show why remuneration should be paid for someone who is helping out in the office work, in the guise of return of brokerage when the payment, had it been made, could be legitimately claimed as salary payment. The AO is also right in not accepting the explanation of the assessee in this behalf on the ground that the assessee itself was maintaining separate accounts for traveling, conveyance, tea, coffee etc. and there was no good reason to debit such expenses to the brokerage returned account. In any case, the break-up into conveyance, remuneration, tea, coffee etc. was not given by the assessee. The AO had also made a point that the debits to the *sauda* brokerage account were in abbreviated forms from which nothing could be made out and the assessee's answer to the same was that the narrations were entered by the accountant and because of the limitation in the software regarding the number of characters, he had to use abbreviations. Another valid point raised by the AO was that the return of the brokerage has not been credited to the clients' personal accounts but has been made through final J.V. account (which probably means journal vouchers). If the assessee's claim is true that it returned part of the brokerage charged from high-value clients as incentive for introducing new clients, one would expect the amounts to be credited first to the personal accounts of the clients after making the necessary calculations in that behalf depending upon the number of

new clients introduced, the business given by them, and so and so forth. Thereafter, payments would have been effected or adjustments against the debit for brokerage charged from them would have been made. This would have ensured that the correct amount of brokerage due to them was being returned and would also serve as a kind of control over the entire transactions. But it is very un-usual to debit the payment straight away to the *sauda* brokerage account. In fact it is not even clear whether the payments were actually made as debited in the *sauda* brokerage account and it was this aspect that was highlighted by the learned SR.DR when he submitted that the mode of payment of the brokerage itself has not been proved by the assessee. This submission has relevance to the argument advanced on behalf of the assessee that there is no evidence to show that the payments have come back to the assessee. In our opinion, if the payment itself is not proved beyond doubt, then the argument that there is no evidence to show that the amounts have come back to the assessee is of no effect.

13. In the course of the hearing the learned SR.DR drew our attention to para-4.1 of the order of the CIT(A) for the assessment year 2000-2001 in the assessment proceedings wherein there is reference to the assessee's inability to produce the clients before the AO in response to the AO's letter dated 27-9-2004 issued on a direction from the CIT(A) who was hearing the appeal earlier. We requested both the parties to produce the said letter before us, if possible and adjourned the matter for a day. On the next date of hearing both the parties expressed their inability to locate and place the letter for our perusal.

14. Having regard to the aforesaid discussion, we are of the view that *Explanation* 1 to Section 271(1)(c) is applicable to the present case and the AO was right in imposing penalty on the assessee for both the years in respect of the disallowance made under the head "diversion of income in the name of

excess brokerage paid back". We accordingly dismiss the assessee's appeal for both the years.

15. ITA No.1052/Ahd/2007 is an appeal by the department for the assessment year 2000-2001 and we have earlier reproduced the ground taken. We have already seen that the Tribunal has restored the matter relating to the disallowance of the jobbing loss to the file of the AO for fresh consideration. No penalty can therefore be imposed with reference to this disallowance. The penalty has therefore been rightly reduced by the CIT(A) by not taking into account the disallowance of the jobbing loss of Rs.17,35,790/- made for the assessment year 2000-2001. Accordingly, the appeal is dismissed.

16. In the result, the two appeals filed by the assessee for the A.Y.2000-2001 and 2001-2002 and the appeal filed by the department for the A.Y.2000-2001 are dismissed with no order as to costs.

Order pronounced in Open Court on 13th August, 2009.

Sd/-	***Sd/-***
(N.S.SAINI)	(R.V.EASWAR)
ACCOUNTANT MEMBER	VICE-PRESIDENT

Place : Ahmedabad
Date : 13-08-2009

Copy of the order forwarded to:

1) : Assessee
2) : Respondent
3) : CIT(A)
4) : CIT concerned
5) : DR, ITAT.

BY ORDER

DR, ITAT, AHMEDABAD