



MAD HC: Suspicion However Grave Cannot Replace Proof; Section 68 Addition and Section 10(38) Exemption Upheld

Facts of the case:

Sohanraj Uttamchand ('the Assessee') filed his return for AY 2014-15 admitting income of Rs. 11,88,22,830. During scrutiny u/s 143(3) of the Income-tax Act, 1961 ('the Act'), the Assessing Officer ('AO') found that the assessee had sold 7,72,000 shares of PFL Infotech Limited for Rs. 34,68,10,572, claiming Long Term Capital Gain ('LTCG') of Rs. 32,90,96,125 as exempt u/s 10(38). A survey u/s 133A revealed alleged price manipulation and a "pump and dump" operation. The AO concluded that the company had no financial standing, the share price rose abnormally from Rs. 22.38 to Rs. 760 without fundamentals, the assessee lacked share trading experience, purchases were based on an undisclosed "tip", certain purchasers gave contradictory statements, and the transaction was an accommodation entry. The AO treated the sale proceeds as unexplained cash credit u/s 68, alternatively as business income u/s 28, and denied section 10(38) exemption. The CIT(A) confirmed the assessment. The Tribunal allowed the assessee's appeal and deleted the addition. The Revenue appealed to the Madras High Court u/s 260A. A connected appeal (T.C.A.No.721 of 2018) involving the assessee's brother, Sohanraj Praveen Kumar, on similar facts relating to Risa International Limited, penalty appeals u/s 271(1)(c), and writ petitions challenging reopening based on the same findings were heard together.

Assessee's contentions:

The Assessee argued that the Revenue's case rested on suspicion, surmise and conjecture, not concrete, corroborated material directly connecting either assessee with the alleged manipulation. The AO had established suspicion regarding third parties but no independent finding that either assessee was privy to or complicit in any manipulation. It was undisputed that: (i) shares were purchased and sold through recognised stock exchanges; (ii) Securities Transaction Tax ('STT') was paid; (iii) sale consideration was received through banking channels; and (iv) in the case of Risa International Limited, allotment was pursuant to a Scheme sanctioned by the Bombay High Court. Though SEBI briefly suspended trading in Risa International Limited, that order was set aside by the Securities Appellate Tribunal, and no adverse action was ever taken against either assessee by any regulatory or investigative agency. The buyers were unrelated third parties unknown to the assessees; the Revenue, possessing powers u/ss 131 and 133(6), failed to trace them, with several summonses returning unserved. The statements of Prasanta Bose and other intermediaries disclosed a modus operandi by unrelated entry-operators in a small fraction of trading volume and did not implicate either assessee by name. Reliance was placed on *Dhakeshwari Cotton Mills Ltd v. CIT* and *Umacharan Shaw and Bros v. CIT*.



Revenue's contentions:

The Revenue argued that the Tribunal failed to appreciate that the scrutiny revealed huge, disproportionate gains from trading in paper/penny-stock companies devoid of real business substance, rightly taxed as unexplained credit u/s 68 read with section 28. The assessee had no prior share trading expertise yet invested crores in illiquid, unknown companies on an unverified oral "tip" without disclosing the informant's identity, giving rise to an adverse inference. The meteoric rise in share prices—from Rs. 22.38 to Rs. 760 for PFL Infotech and from Rs. 10 to Rs. 600 (later crashing to Re. 0.95) for Risa International—despite negligible turnover and negative reserves was symptomatic of artificial price-rigging. Statements from purchasers, including Aspi Bamanji Vairava (who denied purchasing PFL Infotech shares despite records) and Pratik Pankaj Kumar Shah (whose demat accounts were operated by a third party for commission), showed the buy-side was fabricated. In the Risa International case, the confession of Shri Prasanta Bose disclosed his companies were incorporated solely to provide accommodation entries to beneficiaries of penny-stock manipulation, and Abhinandan Jain admitted the price was artificially inflated by named operators. Reliance was placed on *Sumathi Dayal v. CIT* and *CIT v. Durga Prasad More* to emphasize the test of human probabilities and that apparent genuineness on paper cannot be conclusive when surrounding circumstances render the transaction inherently improbable.

Ruling by Madras High Court:

The Madras High Court dismissed the Revenue's appeals and upheld the Tribunal's order, holding:

1. **Scope of section 260A Appeal (Dismissed):** An appeal u/s 260A lies only on a substantial question of law. Findings of fact by the Tribunal, being the final fact-finding authority, are binding unless perverse—arrived at without evidence, in disregard of relevant material, or by taking into account irrelevant material, such that no reasonable person could have reached that conclusion. The Court's jurisdiction is not second appellate re-appreciation of evidence but confined to correcting errors of law, including perversity.
2. **Suspicion Cannot Replace Proof (Dismissed):** The Tribunal had examined every circumstance and held that while the Revenue's circumstances gave rise to strong suspicion, suspicion however grave cannot be equated with proof and cannot displace documentary evidence establishing: (i) shares traded through a recognised stock exchange; (ii) STT paid; (iii) consideration received through banking channels; (iv) the company's identity, listing and trading were never in question; and (v) no positive material showed either assessee paid unaccounted cash or was party to price-rigging. The AO failed to carry the section 131 investigation to its logical conclusion where notices returned unserved, despite purchasers being traceable through stock exchange and depository records. Persons named by intermediaries as orchestrators (Hemat Goelka and Naresh Jain) were never summoned, and no direct nexus with either assessee was shown. The statement of Prasanta Bose, at its highest, showed only a small fraction of trading volume routed through accommodation entities, with no direct connection to the assessee; the balance sheet of the routing company did not disclose holding the shares in question.
3. **Distinguishing Sumathi Dayal and Durga Prasad More (Dismissed):** The Tribunal correctly distinguished those decisions. *Sumathi Dayal* dealt with unaccounted funds disguised as horse race winnings—pure chance—where repeated winnings were humanly improbable. *Durga Prasad More* dealt with unexplained cash credits without comparable documentary trail. Neither laid down an inflexible rule for gains from listed securities traded on a recognised stock exchange with full documentary support. The "test of human probabilities" is a valid tool but does not dispense with the requirement that the Revenue bring positive material connecting the assessee with the alleged design, particularly where primary documentary evidence is unchallenged.



4. **Assessment Cannot Be Based on Pure Guess (Dismissed):** Dhakeswari Cotton Mills Ltd held that the AO's powers, however wide, do not entitle him to base assessment on pure guess without evidence or material; assessment cannot be made on bare suspicion. Omar Salay Mohamed Sait v. CIT reiterated that the Tribunal must not base findings on suspicion, conjecture or surmise, nor act on no evidence or improper rejection of material evidence. An addition sustained principally on suspicion, without concrete, corroborated evidence directly implicating the assessee, cannot stand. Mere steep appreciation in share price does not justify treating capital gain as bogus where shares are traded on a recognised stock exchange, consideration is routed through banking channels, and there is no cogent finding of the assessee's complicity.
5. **Penalty Appeals and Writ Petitions (Dismissed/Allowed):** Since the Court upheld the Tribunal's order deleting the section 68 addition for the same assessment year, the substantial question in T.C.A.Nos.8 and 9 of 2023 was answered against the Revenue, and the Tribunal's order deleting penalty u/s 271(1)(c) was upheld. The writ petitions challenging reopening or reassessment based on the same findings were allowed, and the impugned orders were set aside insofar as they were based on the assessment orders set aside in T.C.A.Nos.714 and 721 of 2018.

Citation:

Sohanraj Uttamchand [TS-1360-HC-2026(Mad)]

Our Comments:

This judgment reinforces that section 68 cannot be invoked mechanically merely because share prices rose steeply or the company lacked credible business substance. The Revenue must bring positive material connecting the assessee with alleged manipulation, particularly where primary documentary evidence trades through a recognised stock exchange, STT payment, banking channel receipt, contract notes, demat statements is unchallenged. Suspicion, however grave, cannot replace proof; an addition sustained principally on suspicion cannot stand. The "test of human probabilities" in Sumathi Dayal and Durga Prasad More remains a valid tool but does not dispense with positive material connecting the assessee with the alleged design. Mere steep appreciation does not justify treating capital gain as bogus where shares are traded on a recognised stock exchange and consideration is routed through banking channels. The AO's powers, however wide, do not permit assessment on pure guess or bare suspicion. The High Court will not interfere with the Tribunal's plausible findings u/s 260A unless perverse. This ruling safeguards assesseees from arbitrary additions based on presumptions and insufficient inquiries.