

DRAFT REPLY ON ALLEGED CAPITAL GAINS FROM PENNY STOCKS IN INCOME TAX ASSESSMENT

To,

Dated:.....

The

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Subject: Reply to Show Cause Notice Regarding Disallowance of Long-Term Capital Gains (LTCG) on Penny Stock Transactions.

Name of Assessee: & **PAN:**

Financial Year: and **Assessment Year:**

Respected Sir/Madam,

We refer to your show cause notice dated addressed to my client proposing to treat LTCG from transactions in penny stocks as undisclosed income.

As instructed by my client, I hereby respond to your notice as follows:

1. Purchase and Sale of Shares: The shares in question were purchased by my client on [Insert Purchase Date], and a copy of the purchase bill was submitted previously. The payment was made through account payee cheque number..... dated, drawn on Bank..... Enclosed herewith is a copy of the relevant bank statement (Annex-A).

The shares were transferred to my client's DEMAT account on dated....., as evidenced by the enclosed DEMAT statement (Annex-B). These shares are listed on the Bombay Stock Exchange.

My client sold the shares after holding them for more than 12 months, with the shares being transferred from the DEMAT account on [Insert Sale Date]. The payment was received via account payee cheque number dated, drawn on Bank..... Relevant bank statement copies are enclosed (Annex-D), along with a copy of the contract note (Annex-E). The Securities Transaction Tax was duly paid, as shown in the contract note.

2. Compliance with Section 10(38): The gain arising from the sale of these shares qualifies as LTCG and is exempt under Section 10(38) of the Income Tax Act, as the shares were held for more than 12 months.

3. No Cash Transactions: Contrary to the allegations in your notice, my client has not converted cash into cheques through trading in these shares. No cash/money was paid to any individual named ABC, as previously stated during proceedings under Section 131 of the Income Tax Act, 1961.

4. Supporting Documentation: The LTCG earned from these transactions is supported by contract notes, bills, and transactions conducted through a recognised stock exchange, all verified. All transactions were executed via account payee cheques, fulfilling all conditions for recognising LTCG.

5. Investment Decisions: Investment in the stock market does not mandate purchasing shares of companies frequently mentioned in the media. My client's investment decisions, including the choice of shares and timing, are independent and based on available opportunities.

6. Verification of Documents: All relevant documents and submissions have been previously furnished, including during an inspection by your department. The address of the broker and the transactions can be further verified if required.

7. Jurisprudence: I would like to draw your attention to several judicial precedents supporting the genuineness of my client's transactions:

- **The Supreme Court, Dhakeswari Cotton Mills Ltd. v. CIT [(1954) 26 ITR 775 (SC)]:** No adverse conclusions can be drawn without substantial evidence. ITO, while making assessment, is not entitled to make a pure guess and make an assessment without reference to any evidence or any material at all. This judgement was recently followed by the ITAT Pune in the case of **ACIT vs Govind Jaikrishna Dane & Sons (PUNE-Trib.) :(2022) 108 TLC 263, (2023) 148 taxmann.com 478.**

- **The Supreme Court, Principal Commissioner of Income Tax vs Renu Aggarwal (SC) :(2023) 119 TLC 029 :** There was no adverse comment from Stock Exchange or Company whose Shares involved. Assessing Officer quoting facts pertaining to completely unrelated persons, Name of Assessee neither quoted by any such persons nor material relating to assessee found in investigation. Tribunal affirming and High Court dismissing department's appeal. Supreme Court dismissed special leave petition.

- **The High Court of Calcutta, CIT v. Eastern Commercial Enterprises (1994) 210 ITR 103 : (1995) 123 CTR 217 :** Statements made by third parties cannot be used without providing the opportunity for cross-examination.

- **The High Court of Gujarat, CIT-I v. Maheshchandra G. Vakil :(2013) 40 taxmann.com 326 : (2013) 220 Taxman 166 :** Proving the genuineness of share transactions through documentary evidence disallows treating capital gains as unexplained cash credit. Where assessee proved genuineness of share transactions by contract notes for sale and purchase, bank statement of broker, demat account showing transfer in and out of shares, as also abstract of transactions furnished by stock exchange, Assessing Officer was not justified in treating capital gain arising from sale of shares as unexplained cash credit

- **The High Court of Madhya Pradesh, Chief Commissioner of Income-Tax (OSD) vs Nilesh Jain (HUF) (MP-HC) :(2024) 128 TLC 376 :(2024) 163 taxmann.com 229 :** The assessee bought shares of a company listed on the Bombay Stock Exchange using a DEMAT account. The payments were made through banking channels and Security Transaction Tax was paid. This fulfilled all conditions for exemption under section 10(38). Therefore, the Assessing Officer cannot question the authenticity of these shares or label them as bogus to make an addition under section 68.

- **ITAT Mumbai, Smt. Hema Ramesh Jain vs Income Tax Officer (MUM-Trib.) :(2024) 125 TLC 595 :(2024) 162 taxmann.com 440 :** The assessee claimed exemption on Long Term Capital Gains (LTCG) from the sale of shares under section 10(38). To validate this transaction, the assessee provided primary documents such as debit-note, share certificate, and demat statement. The sale of shares through the stock exchange was confirmed by a sales contract, and the payment for the shares was made through a banking channel. Therefore, the assessee's claim should be allowed.

- **ITAT Surat, Sanjay Kumar Damjibhai Gangani vs Assistant Commissioner of Income Tax, (SRT-Trib.) :(2024) 127 TLC 344 (2024) 161 taxmann.com 606 :** Where assessee earned long term capital gain on

sale of shares (Sunrise) which was claimed as exempt under section 10(38) and had furnished complete evidence including contract note of shares, demat details, detail of bonus shares and no adverse evidence was brought against such evidence, Assessing Officer was not justified in making addition in respect of LTCG on sale of shares as unexplained cash credit.

Prayer:

In light of the above, I humbly request that the proposed action to add the LTCG as undisclosed income be dropped. All documentary evidence supports the genuineness of the transactions. Should any further clarification be required, my client is prepared to provide it.

Thanking you,

Yours faithfully,

[Name of Advocate/Chartered Accountant/A.R.]

on behalf of [Insert Name of Assessee]

[Enclosures: As stated]

Disclaimer: This Draft has been prepared and shared with our understanding of the law. Based on this draft, the author is in no way responsible for any action or inaction. Please consult the Bare Act and the latest case laws to update the same. This is neither the author's legal opinion nor legal advice.