IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI I-2 BENCH, NEW DELHI
[Coram: Pramod Kumar AM and Sudhanshu Srivastava JM]

ITA Nos. 2 and 5030/Del/2017
Assessment year: 2012-13

Topcon Singapore Positioning Pte Ltd **…….....Appellant**
Unit No. 101 to 106A, ABW Tower 1st floor
M G Road, Sector 25, Gurgaon 201 301
[PAN: AAECT2898N]

Vs

Deputy Director of Income Tax
International Taxation- 3(1)(1), New Delhi **…….…….....Respondent**

Appearances by
Ajay Vohra, Senior Advocate
along-with **Neeraj Jain and Deepika Agarwal** *for the appellant*
Sanjay Kumar Yadav *for the respondent*

Date of concluding the hearing : May 24, 2018
Date of pronouncing the order : August 23, 2018

O R D E R

Per Pramod Kumar, AM:

1. These two appeals pertain to the same assessee, involve somewhat interconnected issues and we heard together. As a matter of convenience, therefore, both of these appeals are being disposed of by way of this consolidated order.

2. The main appeal is ITA No. 2/Del/2017 which is directed against the order dated 31st October 2016 passed by the Assessing Officer under section 143(3) r.w.s. 144C of the Income Tax Act, 1961, for the assessment year 2012-13. We will take up this appeal first.

3. Grievance of the assessee, in substance, is that, on the facts and in the circumstances of the case, the arm's length price adjustment of Rs 1,28,39,903, in respect of consideration for sale of shares in an Indian company, by the assessee company to another non-resident entity, is unsustainable in law.

4. To adjudicate on this grievance, only a few material facts need to be taken note of. The assessee before us is a Singapore based company which held 7,49,999 shares in an Indian company by the name of Topcon Sokkia India Pvt Ltd (TSIPL, in short), and 1 share

was held by Suntaro Tanaka in fiduciary capacity, on behalf of the company, by its director. All these shares were sold by the assessee company to another non-resident company, i.e. Topcon Corporation, Japan (TC-J, in short). The appellant had entered into a 'Stock Purchase Agreement' with TC-J on 1st April 2011, and, under this agreement, the assessee was to sell the TSIPL shares on the basis of its 'Net Asset Value', i.e. NAV, which, at that point of time, was estimated to be US $ 34,00,000 on the basis of figures then available. What was, anyway, agreed upon was the formula on the basis of which the sale consideration was to be worked out, and not the sale consideration itself in money terms. Be that as it may, the sale finally took place at US $ 35,08,000, as authorised by the board of directors resolution dated 9th May 2011, which worked out to Rs 206.88 per share – as against the value of Rs 224 per share on the net asset value basis. This sale price was, in any case, stated to be more than the fair market value of Rs 187 per share as ascertained by the independent valuer on discounted cash flow method. When the assessee filed its return of income disclosing the capital gains on sale of these shares, the Assessing Officer referred the matter to the Transfer Pricing Officer for determination of arm's length price of the shares sold by the assessee. The TPO noted that based on the NAV of the shares, the shares ought to have been sold for US $ 37,98,298.50, whereas the actual sale consideration of shares is only US $ 35,08,000. The plea of the assessee that DCF (discounted cash flow) valuation of these shares, which is a judicially accepted method of valuation of shares in the cases of unquoted shares, is much below the actual sale consideration was rejected by the TPO. The TPO thus concluded that "arm's length price for transfer of shares" is US $ 37,98,298.50, and proceeded to compute capital gains on sale of the shares at Rs 4,96,54,075- as against capital gains of Rs 3,57,37,7840 disclosed by the assessee. As he did so, he discussed various aspects of the valuation of shares but, for the reasons we will set out in a short while, it is not really necessary to deal with his line of reasoning in detail. The observations made by the TPO, in respect of the computation of capital gains, were accepted and adopted by the Assessing Officer. Based on the observations made by the TPO, in respect of determined the capital gains on sale of shares, the Assessing Officer proposed to make an addition of Rs 1,39,16,235 in respect of understatement of capital gains on sale of shares in questions. Aggrieved by the Assessing Officer proposing to the computation of capital gains on this basis, the assessee raise grievances before the Dispute Resolution Panel but without much success. The stand of the TPO, which was adopted by the Assessing Officer, was thus confirmed by the DRP as well. It was in this backdrop that the impugned assessment order was framed, aggrieved by which the assessee is in appeal before us. While suggesting the impugned addition, the TPO has, inter alia, observed as follows:

> **7. The submission of the assessee has been considered and it is found that the assessee company has transferred the shares of Topcon Sokkia India Pvt Ltd (subsidiary company of the assessee) to Topcon Corporation Japan (Holding Company) at Rs 206.88/- while the price of the share is calculated at Rs 224/- by Net assets value method. The calculation of NAV is shown and discussed above in this order. Hence, it is not being discussed here again.**

This share is not listed in any stock exchange and if the share of any company is not listed in any stock exchange, the value of share for sale/transfer should be determined on the basis of book value i.e. Rs 224/- per share. The assessee has received the payment for transfer/sale of share as given below:

Date	Amount received in USD
01.04.2011	34,00,000
28.04.2011	1,08,000

The assessee has used the conversion rate of Dollar to Rupee @ 44.23 which was on 09.05.2011 while the conversion rate USD to INR was 45.21 on 01.04.2011 and 44.35 on 28.04.2011. Therefore, it is found that the assessee has taken incorrect conversion rate. The conversion rate should be used 45.21 which is on the date of receiving of first and major amount of transfer of share and further received amount is also converted on this rate only as per sec 48 read with rule 115A.

This TT buying selling rate has been taken as per Sec. 48 read with rule 115A.

As per Section 48 of the Income Tax Act, 1961, the income chargeable under the head "Capital Gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely:-

(i) expenditure incurred wholly and exclusively in connection with such transfer;
(ii) the cost of acquisition of the asset and the cost of any improvement thereto;

Provided that in the case of an assessee, who is a non-resident, capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred whoIIy and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilised in the purchase of the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so, however, that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter in, and sale of, shares in, or debentures of, an Indian company.

8. The calculation of Arm's Length Price for transfer of share is as given under:

Value of shares in USD @ Rs206.88/- per share	**-**	**35,08,000**
Value of shares in USD @ Rs224/- per share	**-**	**37,98,298.5**
Cost of acquisition in USD	**-**	**27,00,000**
Short Term Capital gain in USD	**-**	**10,98,298.5**
Exchange Rate	**-**	**45.21 (as discussed in Para 7)**
Short term capital gain in INR	**-**	**4,96,54,075**
Less: STCG already calculated by assessee	**-**	**3,57,37,840**
Difference	**-**	**1,39,16,235**

9. The Assessing Officer shall enhance the income of the assessee by an amount of Rs1,39,16,235/- while computing its total income. The Assessing Officer may examine issue of initiation of penalty u/s 271(1)(c) of the Act in accordance with Explanation 7 of the same."

5. We have heard the rival contentions, perused the material on record and duly considered facts of the case in the light of the applicable legal position.

6. In our considered view, as the scheme of Section 92CA is, all that is required to be done by the Transfer Pricing Officer is to determine the arm's length price, which essentially refers to the consideration for which, on a conceptual note, a set of independent enterprise should have entered into similar of transaction as the international transaction, of the international transaction referred to him or of such other international transaction as may come to his notice during the course of proceedings before him. The entire exercise is intended to find out, and eliminate- by way of an ALP adjustment, the impact of intra AE relationship on the transaction value. Of course, where the consideration for which the intra AE transaction has taken place is less than such a hypothetical arm's length price, no adjustment are called for. The role of the TPO must remain confined within these parameters. It is not open to the TPO to go beyond this role of determining the ALP and intrude in the exclusive domain of the Assessing Officer to determine the income taxable in the hands of the assessee. In the case of Cushman & Wakefield India Ltd Vs CIT [(2014) 367 ITR 730 (Del), Hon'ble jurisdictional High Court had an occasion to examine the role of the Transfer Pricing Officer, though in a slightly different context, and Their Lordships were pleased to observe that "the authority of the TPO is to conduct a transfer pricing analysis to determine the ALP" and it does not extend to the areas earmarked for the Assessing Officer, such as, "to determine whether there is a service or not from which the assessee benefits". "That aspect of the exercise", as noted by Their Lordships, "is left to the AO". While observing so, Their Lordships referred to, with approval, the decision of a coordinate bench in the case of Dresser-Rand India (P.) Ltd. v. Addl. CIT [(2011) 47 SOT 423 (Bom)]. The views so expressed by Hon'ble jurisdictional High Court fortifies our understanding that the role

played by the TPO must remain confined to determining the ALP and that it does not, in any case, extend to the exclusive domain of the Assessing Officer in determining the taxable income of the assessee.

7. Let us, in the light of these discussions, revert to the facts of this case. The short question before the TPO was as to what should be the ALP of the shares sold by the assessee company, and such a determination of ALP was required to be done on the basis of the mandate of Section 92C. The fact that the sale took place at US $ 35,08,000 is beyond any dispute and controversy, and yet the case of the TPO is that the arm's length price of these shares is US $ 37,98,298.50 because that is the value as per the NAV method originally agreed between the parties. On a technical note, a price decided, even if that be so, between the associated enterprises- as the assessee and the buyer of shares are, can never be a valid CUP input for the simple reason that it is only the transaction value for transactions between the independent enterprises that the transaction value can be considered as a comparable uncontrolled price. In an intra AE situation, the transaction value cannot be said to be an uncontrolled price at all. Nothing, therefore, turns on the original agreement terms and it has no relevance in determination of arm's length price. The very approach of the TPO is thus vitiated in law.

8. The next question thus is as to on what basis the arm's length price of unquoted shares can be ascertained. Section 92C of the Act does refer to the methods by which the arm's length price can be determined, but none of the methods set out therein, namely Comparable Uncontrolled Price, Resale Price Method, Cost Plus Method, Profit Split Method or Transactional Net Margin Method admittedly apply to the present case but, in residuary clause, it refers to "such other method as may be prescribed by the Board". In exercise of these powers, the CBDT has notified the sixth method as "any method which takes into account the price charged or paid, or would have been charged or paid for the same or similar transaction between non associated enterprises, under similar circumstances, considering all the relevant facts". While on this aspect of the matter, it may be mentioned that a coordinate bench of the Tribunal, in the case of Toll Global Forwarding India Pvt Ltd Vs DCIT [(2014) 152 ITD 283 (Del)] has held this method to be retrospective in effect right from the time the transfer pricing provisions have been introduced, and this coordinate bench decision has been upheld by Hon'ble Delhi High Court in the case of PCIT Vs Toll Global Forwarding India Pvt Ltd [(2016) 381 ITR 38 (Del)]. The question, therefore, that we need to consider is as to on what basis the price which would have been charged for sale of these shares can be ascertained. On this aspect, we find guidance from Hon'ble Supreme Court's judgment in the case of CGT Vs Kusumben D Mahadevia [(1980) 122 ITR 38 (SC)] wherein Their Lordships have, inter alia, observed as follows:

4. It is clear …… that where the shares in a public limited company are quoted on the stock exchange and there are dealings in them, the price prevailing on the valuation date would represent the value of the shares. But where the shares in a public limited company are not quoted on the stock exchange or the shares are in a private limited company the proper method of valuation to be adopted would be the profit earning method. This method may be applied by taking the dividends as reflecting the profit earning capacity of the company on a reasonable commercial basis but if it is found that the dividends do not correctly reflect the profit earning capacity because only a small proportion of the profits is distributed by way of dividends and a large amount of profits is systematically accumulated in the form of reserves, the dividend method of valuation may be rejected and the valuation may be made by reference to the profits. The profit earning method takes into account the profits which the company has been making and should be capable of making and the valuation, according to this method is based on the average maintainable profits. Of course, for the purpose of such valuation, the taxing authority is not bound by the figure of profits shown in the profit and loss account because it is possible that the amount of profits may have suffered diminution on account of unreasonable expenditure or the directors having chosen to take away a part of the profits in the form of remuneration rather than dividends. The figure of profits in such a case would have to be adjusted in order to arrive at the real profit earning capacity of the company. It would, thus, be seen that in the case of a company which is a going concern and whose shares are not quoted on the stock exchange, the profits which the company has been making and should be capable of making or, in other words, the profit-earning capacity of the company would ordinarily determine the value of the shares. That is why in Mahadeo Jalan's case (supra) the Court quoted with approval the following observations of Williams, J. in McCathie vs. Federal Commissioner of Taxation (69 Commonwealth Law Reports 1): "...the real value of shares which a deceased person holds in a company at the date of his death will depend more on the profits which the company has been making and should be capable of making, having regard to the nature of its business, than upon the amounts which the shares would be likely to realise upon a liquidation," and stated in no uncertain terms that: "The general principles of valuation in a going concern is the yield on the basis of average maintainable profits, subject to adjustment, etc., which the circumstances of any particular case may call for." The break-up method would not be appropriate for valuation of shares of a company which is a going concern, because as pointed out by the Court in Mahadeo Jalan's case (supra), "among the factors which govern the consideration of the buyer and the seller where the one desires to purchase and the other wishes to sell, the factor or break-up value of a share as on liquidation hardly enters into consideration where the shares are of a going concern". It is only where a company is ripe for winding up or the situation is such that the fluctuations of profits and uncertainty of conditions at the date of valuation prevent any reasonable estimation of the profit earning capacity of the company, that the valuation by the break-up method would be justified. The Revenue leaned heavily on the observation in Mahadeo Jalan's case (supra) that the factors likely to determine the valuation of a share include "in special cases such as investment companies, the asset-backing" and urged on the strength of this observation that in the case of an investment company, the asset-backing was a relevant consideration and the break-up method could not, therefore, be considered as totally irrelevant. This contention, we are afraid, is based on a wrong reading of the observation of the Court. When the Court said that in the case of an investment company, the asset-backing is a relevant factor in the determination of the value of the shares, what the Court meant was that in order to determine the capacity of the company to maintain its profits the asset-backing would be a relevant consideration. The profit- earning capacity of the company which would determine the valuation of the

shares would naturally have to take into account not only the profits which the company is actually making but also the profits which the company should be capable of making and in order to arrive at a proper estimation of the latter, the asset-backing would be a relevant factor in the case of an investment company. It would not be right to read the observation of the Court as suggesting that valuation of the assets would be a relevant factor in determining the valuation of the shares. The Revenue, of course, did not plead for exclusive adoption of the break-up method and wanted the mean of the values arrived at by applying the break-up method and the profit-earning method to be taken as representing the valuation of the shares, but we do not see on what principle can a combination of the two methods be justified. There is no authority either in any judicial decision or in any standard text-book on valuation of shares which recognises the validity of a combination of the two methods, though it may sound acceptable as a compromise formula. In fact, Adamson has criticised this combination of the two methods as unscientific in his book on The Valuation of Company Shares and Business (fourth edn.), at page 55, where he has said :

"The mere averaging of two results obtained by quite different bases of approach can hardly be said to represent any logical approach, whatever its merit as a compromise. Despite its evident popularity in any quarters, it has not been given judicial recognition in decisions involving the fixation of a value by the Court."

The combination of the two methods advocated on behalf of the Revenue has, thus, no sanction of any judicial or other authority and cannot be accepted as a valid principle of valuation of shares.

5. The Revenue then pointed out that the principles of valuation set out by the Court in Mahadeo Jalan's case (supra) were merely broad guidelines and they did not obviate the necessity of considering each case on its own facts and circumstances and in support of this contention the Revenue relied on the observation made by the Court that in setting out these principles, the Court had not "tried to lay down any hard and fast rule because ultimately the facts and circumstances of each case, the nature of the business, the prospects of profitability and such other considerations will have to be taken into account as will be applicable to the facts of each case". Now it is true, as observed by the Court, that there cannot be any hard and fast rule in the matter of valuation of shares in a limited company and ultimately the valuation must depend upon the facts and circumstances of each case, but that does not mean that there are no well settled principles of valuation applicable in specific fact-situations and whenever a question of valuation of shares arises, the taxing authority is in an uncharted sea and it has to innovate new methods of valuation according to the facts and circumstances of each case. The principles of valuation as formulated by the Court are clear and well-defined and it is only in deciding which particular principle must be applied in a given situation that the facts and circumstances of the case become material. It is significant to note that immediately after making the above observation the Court hastened to make it clear, as if in answer to a possible argument which might be advanced on behalf of the Revenue on the basis of that observation that "the yield method is the generally applicable method while the break-up method is the one resorted to in exceptional circumstances or where the company is ripe for liquidation."

6. Here, in the present case, Mafatlal Gagalbhai Pvt. Ltd. was a private limited company which was a going concern and it was neither ripe for liquidation nor were there any exceptional circumstances which should attract the applicability of the break-up method. The profit earning method was, therefore, the only method which could

properly be applied for arriving at the valuation of the shares in the company and the Tribunal was right in accepting the figures of valuation in the report of M/s C.C. Choksy & Co. based on the application of the profit earning method. The answer to the question of law relating to the method to be adopted for valuation of shares in the company was clearly concluded by the decision in Mahadeo Jalan's case (supra) and the High Court was therefore, justified in refusing to call for a reference on this question.

9. In the present case, the company in which shares were transferred was not in the winding up nor was there any reasonable prospect of its going into liquidation. In these circumstances, the adoption of Net Asset Value or book value was not really warranted. We reject the same. Given the fact that it was treating as a going concern, the valuation on the basis of future earnings was quite justified. To this extent, we disapprove the stand of the authorities below. However, since the TPO has not examined that aspect of the matter at all and simply proceeded on the basis of net asset value, we also deem it fit and proper to remit the matter at the assessment stage in the light of fresh determination of arm's length price in the light of our directions above. The TPO shall discard the computations based on Net Asset Value and adopt an appropriate method of determining the ALP of shares sold by the assessee to its AE, and if such an ALP is found to be more than the transaction value of US $ 35,08,000, the ALP adjustments will be required. The matter is thus required to be adjudicated afresh in a fair and reasonable and legally sustainable manner. While doing so, he will decide the matter in accordance with the law, by way of a speaking order and after giving a fair and reasonable opportunity of hearing to the assessee. Ordered, accordingly.

10. In ITA 1050/Del/2017, the assessee has raised certain grievances against the order rectifying mistake apparent on record, under section 154, in respect of the above order. As the said assessment itself is remitted back to the assessment stage, this appeal is rendered academic and infructuous, and is dismissed as such.

11. In the result, while ITA No. 2/Del/2017 is allowed for statistical purposes, ITA No. 5030/Del/17 is dismissed as infructuous. Pronounced in the open court today on the 23rd day of August, 2018.

Sd/- Sd/-
Sudhanshu Srivastava **Pramod Kumar**
(Judicial Member) (Accountant Member)

New Delhi, Dated the 23rd day of August, 2018

Copies to: *(1)* *The appellant* *(2)* *The respondent*
(3) *CIT* *(4)* *CIT(A)*
(5) *DR* *(6)* *Guard File*

By order
Assistant Registrar
Income Tax Appellate Tribunal
Delhi benches, New Delhi