

आयकर अपीलिय अधिकरण, विशाखापटणम पीठ, विशाखापटणम

**IN THE INCOME TAX APPELLATE TRIBUNAL,  
VISA KHAPATNAM BENCH, VISA KHAPATNAM**

श्री वी. दुर्गा राव, न्यायिक सदस्य एवं  
श्री डि.एस. सुन्दर सिंह, लेखा सदस्य के समक्ष

**BEFORE SHRI V. DURGA RAO, JUDICIAL MEMBER &  
SHRI D.S. SUNDER SINGH, ACCOUNTANT MEMBER**

आयकर अपील सं./I.T.A.No.270/Viz/2018  
(निर्धारण वर्ष/Assessment Year:2013-2014)

Sri Kumar Pappu Singh  
D.No.23-3-26, Sundaram Nagar  
Sajjapuram  
Tanuku  
[PAN : AEEPP2496P]

Vs. Dy.Commissioner of  
Income Tax,  
Circle-1, KKS Towers,  
RR Pet, Eluru  
Andhra Pradesh

**(अपीलार्थी/ Appellant)**

**(प्रत्यर्थी/ Respondent)**

निर्धारिती की ओर से/ Assessee by : Shri K.C.Devdas, AR  
राजस्व की ओरसे/ Revenue by : Shri D.K.Sonowal, CIT DR

सुनवाई की तारीख / Date of Hearing : 24.10.2018

घोषणा की तारीख/Date of Pronouncement : 07.12.2018

**आदेश /ORDER**

**PER D.S. SUNDER SINGH, Accountant Member:**

This appeal is filed by the assessee against the order of the Principal Commissioner of Income Tax(Pr.CIT), Rajahmundry vide F.No.Hqrs/6/Pr.CIT(A)/Rjy/2016-17 dated 28.03.2018 for the assessment year (A.Y.) 2013-14.

2. The assessee filed the return of income admitting total income of Rs.49,73,600/- for the A.Y. 2013-14. The case was taken up for scrutiny and the assessment was completed u/s 143(3) on total income of Rs.60,58,640/-. Subsequently, the Ld.Pr.CIT, Rajahmundry called for the records and found that the assessee had received 1,50,000 shares from M/s Jai Maakali Poultry Products for a consideration of Rs.100/- per share, while the fair market value of the company was at Rs.416.38 per share. Thus, the assessee paid less than the fair market value for acquisition of shares. Accordingly the Ld.Pr.CIT observed that the income was short computed by an amount of Rs.4,74,57,000/- [Rs.316.38 (Rs.416.38 - Rs.100) x 1,50,000] which is chargeable to tax u/s 56(2)(vii)(c) of the Income Tax Act, 1961 (hereafter called as 'Act'). The Ld.Pr.CIT further observed that the assessee himself had received the entire enhanced equity of the company under the rights issue and the other seven share holders did not receive any shares from the enhanced share capital of the company. Hence, the Ld.Pr.CIT found that the aggregate fair market value of the shares that exceeded the consideration paid is chargeable to tax u/s 56(2)(vii)(c) of the Act and found that the AO has not examined the issue during the assessment proceedings. Therefore issued show cause notice and called for the explanation of the assessee. In reply to the show cause

notice, the assessee filed explanation objecting for the proposed revision u/s 263. The Ld.Pr.CIT in his show cause notice taken the support of the Apex court's decision in the case of M/s Khoday Distilleries Ltd., in civil appeal No.6654 and the assessee argued before the Ld.Pr.CIT that the decision of the Hon'ble High Court in the case of M/s Khoday Distilleries is not applicable in the assessee's case and submitted that the facts of the case are different and distinguishable to the assessee's case. The assessee argued before the Ld.Pr.CIT without conceding, even if the Hon'ble Apex court's decision supra is accepted, the shares allotted in excess of the proportionate ratio is to be considered for taxation, but not the entire allotment. According to the assessee only the difference shares allotted in excess of the eligible ratio (i.e.36,150) to be taken into consideration for taxation but not the entire 1,50,000 shares.

The assessee submitted section 56(2)(vii)(c) of the Act is not applicable in the assessee's case even for excess shares, since other share holders have denounced for applying the rights issue thus there is no case for application of section 56(2)(vii)(c) of the Act.

The Ld.Pr.CIT did not convince with the arguments and explanation made by the Ld.AR. The Ld.Pr.CIT observed that out of 8 shareholders of M/s Jai Makali Poultry Products Pvt. Ltd, the assessee alone had received

1,50,000 shares on payment of Rs.100/- per share during the previous year, whereas the other shareholders did not receive any shares on enhancement of equity of the said company. This allotment resulted in increase in the assessee's shareholding in the company to 91% from the earlier shareholding of 76%. The assessee earlier was holding 75,900 shares out of the total 1,00,000 shares of the company which is increased to 2,25,000 shares from the earlier shareholding of 75,900 shares which works out to 91% of the shareholding. Such increase in the assessee's holding resulted in simultaneous diminution in the holding of the other share holders and the rights in the company to the same ratio. Thus, the Ld.Pr.CIT viewed that the assessee has clearly received tangible property in the form of shares for a consideration which is less than the fair market value of the property for an amount exceeding Rs.50,000/- which also increased his rights over the company to the extent of 91% as against 76% earlier. Therefore, held that the provisions of section 56(2)(vii)(c) are clearly attracted on the facts of the case. The Ld.Pr.CIT distinguished the case law relied upon by the assessee in the case of Sudhir Menon (148 ITD 260) stating that the facts are different in as much as the additional shares were issued on pro rata basis to the existing share holders of the company in the said case against which the entire additional shares were allotted to

assessee in the instant case. The Ld.Pr.CIT observed that in M/s Dorf Ketal Chemicals Pvt. Ltd., Sudhir Menon (HUF) was a share holder and the ITAT in para 4.6 of the order observed that “..No property however being passed on to the assessee in the instant case, i.e. on the allotment of the additional shares, no addition in terms of the provision itself shall arise in the facts of the case..” Whereas in the instant case no such pro-rata allotment took place but on the other hand the assessee’s shareholding increased to 91% from existing 76% and thereby “property” was passed on to the assessee within the meaning of section 56(2)(vii)(c), while the share of other shareholders decreased to 9% from the existing 24%. Hence, the Ld.Pr.CIT held that the ratio of the decision relied upon by the assessee has no application in the assessee’s case.

3. In respect of allotment of shares as a condition of financing bank to convert part of the unsecured loan into equity, the Ld.Pr.CIT was of the view that still the provisions of section 56(2)(vii)(c) are attracted once there is difference in consideration paid and the market value of the shares received by the assessee from the company.

4. The other contention of the assessee raised before the Ld.Pr.CIT is that without conceding, even if it is presumed that section 56(2)(vii)(c) is

applicable in the assessee's case, tax should be levied on what was lost by the existing shareholders and gained by the assessee as under:

Particulars	Before allotment	After allotment
Net worth	416.38 lakhs	566.38 lakhs
No. of shares	1,00,000	2,50,000
Book value per share	416.38	226.55
Value diminished per share on allotment	-	189.83 (416.38-226.55)
No. of shares held by K.Kumar Pappu Singh	75,900	2,25,900
% of holding of Kumar Pappu Singh	75.90%	90.36%
Kumar Pappu Singh entitlement out of 1,50,000 shares		150000*75.90%=1138.50 shares
Extra shares got by Kumar Pappu Singh		36150 shares (150000-1138.50)
Value of shares foregone by other shareholders (36150 shares) @226.55		81,89,782 (A)
Consideration paid by Kumar Pappu Singh on 36150 shares		36,15,000 (B)
Net gain for Kumar Pappu Singh on account of non subscription of the shares by other share holders		45,74,782 (A-B)

The Ld.Pr.CIT rejected the contention of the assessee observing that the assessee has taken fair market value of the shares after the allotment and arrived at the net gain on account of extra shares allotted to the assessee, instead of taking the fair market value as on the date of transfer

before the allotment. Similarly, the quantum of extra shares was worked out by the assessee at 36,150 shares as against 1,50,000 shares received by the assessee. As per the Act, the difference in the value of shares received by the assessee at less than the market value required to brought to tax but not the extra shares worked out by the assessee. Thus, the Ld.Pr.CIT found a fallacy in the alternate working of the assessee and did not accept the contention of the assessee.

5. The third contention made by the assessee was that the case was taken for revision u/s 263 on the basis of audit objection and mere objection cannot lead to inference that the order of the AO was erroneous or prejudicial to the interest of the revenue. In respect of the audit objection, the Pr.CIT viewed that the revision is initiated as there is substance in the audit objection and after due consideration of the facts of the case. The Ld.Pr.CIT further held that the assessment order does not indicate that the AO has raised any queries on the issue which are subject matter of proceedings u/s 263. The Ld.Pr.CIT further observed that the AO has not examined the issue and the assessment was made in a perfunctory manner without making any inquiry or verification about the taxability of

difference in the value of shares allotted to the assessee and accordingly rejected the contention of the assessee.

In the light of the above and in view of the Explanation 2 to sec.263 inserted by the Finance Act, 2015 w.e.f. 01.06.2015, the LD.Pr.CIT, held that the decision of Hon'ble Punjab and Haryana High Court in the case of Sohana Woollen Mills (296 ITR 238) relied upon by the assessee has no application and accordingly held that the assessment made by the AO is erroneous and prejudicial to the interest of the revenue and directed the AO to add the difference between the fair market value and the actual consideration of shares amounting to Rs.4,74,57,000/- as income of the assessee u/s 56(2)(vii)(c) of the Act.

6. Aggrieved by the order of the Ld.Pr.CIT, the assessee filed appeal before this Tribunal. Along with appeal memo, the assessee filed as many as seven grounds in appeal. Subsequently, the assessee filed two additional grounds challenging the validity of revision on the basis of audit objection and the application of section 56(2)(vii)(c) of the Act for the rights issue. During the appeal hearing, the Ld.AR submitted that the assessee company has filed the return of income and was taken up for assessment and in the financial statements, the entire details of allotment of right shares was

made available to the AO and the AO has not raised any query with regard to the allotment of equity shares. Therefore, argued that the issue with regard to the allotment of shares on rights issue required to be considered as examined by the AO, thus there is no case for revision.

7. Secondly, the Ld.AR submitted that there were 8 shareholders in the company, all the shareholders are close relatives of the assessee with the relationship of wife, daughter, sister, brother and son and the transaction was between the close relatives. For the transactions between the close relatives, section 56(2)(vii)(c) has no application as per the Act. The assessee filed the paper book and taken our attention to page No. 38 and 39, wherein, the details of the share holders and their relationship with the assessee were furnished and it is found that all the shareholders are related to the assessee having close relationship of father, wife, daughter, son, sister and brother.

8. The next contention of the Ld.AR is that the company has issued the equity shares on rights basis for which only the assessee had applied and the other relatives did not choose to subscribe for the rights issue. The Ld.AR drew our attention to page No.36 of the paper book, wherein the Board Resolution was placed allotting 1,50,000 shares in rights issue to the

assessee and argued that the company is permitted to offer the excess shares to the available subscribers after initial allotment if there is no claim from the other shareholders. The quantum of offer may be more or less than the paid up share capital of the company. Thus, if the quantum of shares offered is more than the paid up share capital, the shareholders will be offered more than one share for each share held depending upon the quantum of shares offered. As per the Company's Act, if the shareholder who was offered shares does not subscribe for any shares or subscribe less number of shares than offered, then such unsubscribed shares offered to the shareholders can be allotted to the shareholders who subscribe for additional shares. Accordingly, in the present case, seven of the existing shareholders did not subscribe for shares except the assessee Mr. Kumar Pappu Singh. The assessee received 1,13,850 shares on pro-rata basis according to his shareholding of 75,900 shares and was allotted 36,150 shares in excess of his entitlement which was denounced or not subscribed by other shareholders. The Ld.AR submitted that in the rights issue, the shareholders do not get any extra benefit or any amount other than the interest of the shareholder already had, since, all the shareholders of the company are having the interest over the entire assets i.e. reserves and surpluses.

In the instant case, the assessee submitted that there was a compulsion for increase of capital of the company because of the pressure of banks. The assessee had advanced large sums to the company to meet the financial requirements and the banks have insisted the company to increase the capital base by converting the unsecured loans as share capital. The Ld.AR also argued that the issue of allotment of right shares does not increase the assets of the company and do not attract sub section 56(2)(vii)(c) of the Act. Therefore, requested to quash the order passed by the Ld.Pr.CIT. The assessee also relied on the decision of Sudhir Menon Vs. ACIT, Mumbai (148 ITD 260) and argued that the issue of right shares and its allotment does not amount to issue of fresh shares at FMV as the value of the shares and the assets are already embedded in the value of original shares. The assessee also relied on the decision of M/s Khoday Distilleries Ltd. Vs.CIT, wherein Hon'ble supreme court observed in para No. 7 that

*"It was held in company Law the word "allotment" means appropriation out of previously unappropriated capital of the company, of a certain number of shares, to a person and till such allotment, the shares do not exist as such. It is only on allotment that the shares come into existence and in every case the words "allotment of shares" have been used to indicate the creation of shares by appropriation out of the unappropriated share capital to a particular person.*

8. *In our view the judgement in the case of Sri Gopal Jalan & Co vs. Calcutta Stock Exchange Association Ltd. [1964] 3 SCR 698 squarely applies to the present case, wherein it was held that there is a vital difference between "creation" and "transfer" of shares. As stated hereinabove, the words "allotment of shares" has been used to indicate the creation of shares by appropriation out of the unappropriated share capital to a particular person. A*

*share is a chose in action. A chose in action implies existence of some person entitled to the rights in action in contradiction from rights in possession. There is a difference between issue of a share to a subscriber and the purchase of a share from an existing shareholder. The first case is that of creation whereas the second case is that of transfer of chose in action. In this case, when twenty shareholders did not subscribe to the rights issue, the appellant allotted them to the seven investment companies, such allotment was not transfer. In the circumstances, section 4(1)(a) was not applicable as held by the Tribunal. The assessee also relied on the decision of Miss Dhun Dadabhoy Kapadia Vs. CIT [36 ITR 0651]."*

9. With regard to the additional ground, the Ld.AR argued that in the instant case, the assessment was completed u/s 143(3). Subsequently, the AO had issued the notice u/s 154 of the Act, proposing to make adjustment of Rs.4,74,57,000/- u/s 56(2)(vii)(c) of the Act by notice dated 29.07.2016. The assessee filed reply on 09.08.2016 opposing the proposed addition u/s 154 of the Act. Thereafter there was no reply from the AO and meanwhile the proceedings u/s 263 were initiated and completed. Thus argued that the AO has considered the reply and after due verification accepted the reply submitted by the assessee, thus there is no case for revision u/s 263. The Ld.AR further submitted that the assessment was taken up for revision u/s 263 because of the audit objection which was accepted by the Ld.Pr.CIT in the revision order, hence there is no application of mind by the Ld.Pr.CIT and without application of mind, the Ld.Pr.CIT is not permitted to take up the case for revision u/s 263. The Ld.AR relied on the decision of Jaswinder Singh Vs. CIT [150 TTJ 33], wherein Hon'ble ITAT held that audit objection

under no circumstances can be called as record empowering the Commissioner to exercise the jurisdiction 263 of the Act. The Ld.AR also relied on the decision of CIT Vs. Sohana Wollen Mills [296 ITR 238], wherein Hon'ble Punjab & Haryana High Court held that the CIT has no jurisdiction to revise an order u/s 263 on the basis of audit objection.

10. The next contention put forth by the assessee during the appeal hearing is without conceding his earlier objections if, section 56(2)(vii)(c) is applicable in the assessee's case, it has to be applied only to the extent of the excess shares received by the assessee over and above the entitlement of the assessee. On pro rata basis, the assessee is entitled for 1,13,850 shares on the basis of his earlier share holding, thus, the excess shares allotted to the assessee was only 36,150 shares. Hence argued that the entire allotment of shares should not be considered for computing the income under income from other sources. The Ld. AR submitted that the Ld.Pr. CIT considered the fair market value before allotment without comparing the value of each share at the time of allotment held by the assessee. Since the assessee is a shareholder and the assessee is entitled for his share of interest in the company, only the fair market value after allotment need to be considered for the purpose of taxing the income u/s

56(2)(vii)(c) of the Act as per the table given in the earlier paragraphs. Thus argued that the amount required to be brought to tax u/s 56(2)(vii)(c) works out to Rs.45,74,782/, but not the entire sum of Rs.4,74,57,000/- as held by the Ld.Pr.CIT. The Ld.AR invited our attention to page No.19 of the paper book, wherein the value of the shares was computed according to which the book value as on 31.03.2012 was Rs.416.38 per share. The Ld.AR also drew our attention to page No.21 of the paper book, wherein the share value after allotment of equity shares was worked out to Rs.226.55 per share. Thus submitted that the fair market value of the share after allotting 226.55 per share and the net gain for the assessee was Rs.45,74,782/- which required to be considered for the addition u/s 56. Accordingly, the Ld.AR argued that the revision made by the Ld.Pr.CIT u/s 263 is erroneous and requested to quash the order passed by the Pr.CIT.

11. On the other hand, the Ld.DR submitted that the AO has not made any enquiry in the instant case. There was no evidence brought on record to show that the AO has considered the issue during the assessment proceedings. Since the AO neither considered the issue nor made any enquiry and there is a clear under assessment,, the Ld.Pr.CIT has rightly

taken up the case for revision u/s 263. W.e.f. 01.06.2015 as per Explanation 2 of section 263 of the Act, the Pr.CIT is empowered to take up the case for revision if in the opinion of the Ld.Pr.CIT, the order passed by the AO is without making enquiries or verification which should have been made. Therefore, this case squarely falls under Explanation 2 of section 263 and the Ld.Pr.CIT has rightly taken up the case for revision and there is no interference called for in the order. The Ld.DR submitted that the transaction was between the company and the assessee, but not between the relatives and the assessee. Therefore, there is no application of the proviso of non application of section 56(2) in the assessee's case. In respect of audit objection, the Ld.DR argued that even audit objection can become a source of information and there was a substance in the audit objection and the fact is that the assessee has received the shares for lesser value than the fair market value, therefore cannot escape from the records of section 56 of the Act. With regard to the allotment of shares over and above the shareholding of the assessee, the Ld.DR supported the order of the Ld.Pr.CIT. In addition, the Ld.DR relied on the orders of the Ld.Pr.CIT.

12. We have heard both the parties and perused the material placed on record. After discussing with both the parties, the additional grounds

raised by the assessee are admitted as the same are legal grounds in the interest of justice.

In this case, the assessee is shareholder in M/s Jai Maakali Poultry Products and holding 75,900 shares out of total shares of 1,00,000/- which works out to 76% of the total share holding. There are total seven shareholders in the company, all of them are close relatives either legal ascendants or descendants. The assessee has advanced the sum of Rs.427.37 lakhs to the assessee company which is outstanding under unsecured loans. The lending institutions stated to have directed the assessee company to increase the capital base by converting the unsecured loans of shareholders of the company. Therefore, the assessee company issued 1,50,000 shares @Rs.100/- per share under rights issue. The assessee alone had applied for the rights issue and the company has allotted 1,50,000 shares @Rs.100/- per share. Before allotment of the share under rights issue, the fair market value of the share was Rs.416.38 per share. In this case the assessee filed the return of income declaring the total income of Rs.49,73,600/- on 29.09.2013 and the Pr. CIT, Rajahmundry has taken up the case for revision and found that the assessee had received 1,50,000 shares @Rs.100/- per share instead of book value under the rights issue. The Pr.CIT was of the view that the assessee

had received the asset for the value lesser than the book value, therefore, the provisions of section 56(2)(vii)(c) is attracted and the difference consideration of the shares allotted between the book value and the price paid by the assessee required to be brought to tax under the head 'income from other sources'.

13. The Ld.AR submitted that there was no other applicant for the shares under the rights issue, hence, the company had allotted the excess shares to the assessee over and above his entitlement to his proportionate to the shareholding. The Ld.AR submitted that all the shareholders in the company are close relatives and the proviso to section 56(2)(vii)(c) is not applicable in the case of close relatives. The Ld.AR brought to our notice that the remaining shareholders are brothers, sisters, son, daughter, wife etc. as per the details given below.

S.No.	Name	Address	No.of Shares	Share Value as on 01.04.2012	Total Amount in Rs.	Relation-ship
1.	Kumar Pappu Singh	D.No.23-3-26, Sundar Ramnagar, Sajjapuram, Tanuku-534211	75900	100	7,590,000	
2.	Rama Devi	D.No.23-3-26, Sundar Ramnagar, Sajjapuram, Tanuku-534211	3600	100	360,000	Wife
3.	Divya Sree	D.No.23-3-26, Sundar Ramnagar, Sajjapuram, Tanuku-534211	5510	100	551,000	Daughter
4.	Devendra Chowhan	D.No.23-3-26, Sundar Ramnagar, Sajjapuram, Tanuku-534211	5000	100	500,000	Son
5.	Kapil Deo Singh	D.No.134, South Samaj, Lower Bazar, Ranchi-	3400	100	340,000	Father

		834001				
6.	Rajesh Kumar Singh	D.No.134, South Samaj, Lower Bazar, Ranchi-834001	3300	100	330,000	Brother
7.	Deepak Kumar Singh	D.No.23-3-26, Sundar Ramnagar, Sajjapuram, Tanuku-534211	3280	100	328,000	Brother
8.	Saroj Kumari Singh	D.No.134, South Samaj, Lower Bazar, Ranchi-834001	10	100	1,000	Sister
			1,00,000	100	10,000,000	

From the above details it is established that the company is closely held company and all the shareholders are legal ascendants or descendants as defined in the Act under close relatives. For ready reference the definition of close relative given in the act under section 56(2)(vii)(c) of the act in explanation is as under:

(e) "relative" means,—

(i) in case of an individual—

(A) spouse of the individual;

(B) brother or sister of the individual;

(C) brother or sister of the spouse of the individual;

(D) brother or sister of either of the parents of the individual;

(E) any lineal ascendant or descendant of the individual;

(F) any lineal ascendant or descendant of the spouse of the individual;

(G) spouse of the person referred to in items (B) to (F); and

(ii) in case of a Hindu undivided family, any member thereof;]

14. The assessee has only applied for shares which were allotted by the company. The contention of the revenue is that since there is no relation between the company and the assessee there is no case for invoking the explanation of relative to exempt the assessee from taxing the excess fair

market value under the head 'income from other sources'. Whereas, the contention of the assessee is that all the shareholders are relatives. The transaction between the close relatives is not taxable under the head 'income from other sources u/s 56(2) of the Act and hence, the section 56(2)(vii)(c) has no application. We have gone through the provisions of 56(2)(vii)(c) and this provision was brought as an anti-abuse measure, seeks to tax the understatement in consideration as the income in the hands of the recipient (of the corresponding asset) as against the donor in the case of Gift Tax Act. The transactions between close the relatives are outside the scope of application of 56(2)(vii)(c). The legislature in its wisdom excluded the transaction of close relatives for the purpose of taxation under the income from other sources. Even the gifts received from the close relatives u/s 56(2)(v) are outside the scope of 56(2). Though the shares are allotted to the assessee, the entire shareholding of the company is retained by the family and no share was allotted to the outsiders. In this case, though the assessee had received the excess shares, renunciation was from the close relatives and the assessee is at liberty to transfer the shares to other relatives or shareholders at any point of time without attracting the taxation u/s 56(2)(vii)(c). Therefore, surrender of the rights of the close relatives in favour of the another close relative is covered for

exemption u/s 56(2)(vii)(c) of the Act. In the decision rendered by the Hon'ble Madras High Court in the case *CIT v. Kay Arr Enterprises* [2008] 299 ITR 348 and in the decision of the Hon'ble Karnataka High Court in the case *CIT v. R. Nagaraja Rao* [2012] 21 taxmann.com 101/207 Taxman 236/[2013] 352 ITR 565 it has been categorically held that "where there are transactions involving family arrangement with respect to transfer of shares, the corporate veil of the company has to be lifted and inferred that there is no transfer of shares and accordingly capital gain tax is not exigible." From the above it is apparent that even when there are transfer of shares physically, in the event of family arrangements, the Hon'ble High Courts have held that the entire transactions has to be viewed lifting the corporate veil and treat the transaction as if there is no transfer of shares and hence capital gain tax is not attracted. The transaction between the closer relatives should not be seen as introducing black money or evasion of the tax. Therefore, we are of the considered opinion that the transaction is within the family and close relatives and covered by the proviso to section 56(2)(vii)(c) of the Act and there is no application of the said section for taxing the income under the head 'income from other sources'. The coordinate bench of ITAT Chennai in the case of *Vani Estates Pvt. Ltd. Vs. ITO, Corporate Ward-3(4), Chennai*, 98 taxman.com 92 also taken the

similar view in respect of excess share premium for the transactions between the relatives which required to be taxed u/s 56(2)(vii)(b) of the Act.

15. In the instant case, all the shareholders are the relatives within the meaning of proviso to section 56(2)(vii)(c) of the Act. Therefore, we hold that for the excess shares allotted to the assessee, there is no case for application of section 56(2)(vii)(c) of the Act, accordingly, we set aside the order of the Pr.CIT and allow the appeal of the assessee.

16. The next contention of the assessee is that the revision proceedings u/s 263 are taken on the basis of audit objection and the same are not permissible on the basis of audit objection. In this case, the AO initiated the rectification proceedings u/s 154 by issue of notice dated 29.07.2016 proposing to make an addition of Rs.4,74,57,000 under Rule 11U/11UA of the IT Rules for which the assessee submitted explanation opposing the proposed rectification on 09.08.2016. The AO has not communicated the decision after receipt of the reply, to assessee with regard to the dropping/otherwise of the proceedings initiated u/s 154 of the Act. Pending finalization of 154 proceedings, the Pr.CIT has initiated the proceedings u/s 263 by issue of notice dated 19.05.2017. In this case, the

assessment was completed u/s 143(3). The entire material was placed before the AO in the balance sheet, profit and loss account. The initiation of proceedings u/s 263 was due to the audit objection as evident from the order u/s 263. The Ld.Pr.CIT did not dispute the fact that the revision was taken on audit objection he has emphatically stated that there is substance in the audit objection. With regard to taking up the case for revision on the basis of audit objection, the assessee relied on the decision of Jaswinder Singh Vs. CIT (Chandigarh Bench), [2013] 31 taxmann.com 80 (Chandigarh - Trib.) wherein, the coordinate bench held as under :

*“21. The Hon'ble Gauhati High Court in B&A Plantation & Industries Ltd. (supra) has laid down the difference between revisionary, rectification and reassessment proceedings. The fact situation before the Hon'ble Gauhati High Court that rectification proceedings were initiated on the basis of audit objections, which were dropped subsequently and notice under s. 263 of the Act was issued by the CIT on the basis of same audit objections and the Hon'ble Court held that there was no independent application of mind by the CIT and the revision proceedings were held to be not valid. The Hon'ble Gauhati High Court observed as under:*

*"In the case at hand, the order, initiating rectification proceedings under s. 154, as well as the order revising the assessment under s. 263, were passed on the basis of one and the same audit objection. While exercising revisional jurisdiction, the revisional authority must bear in mind that the principles of natural justice do not permit the decision of a quasi-judicial authority, such as a CIT, to be influenced by any other authority. Thus, the CIT, in the present case, could not have initiated a suomotu revisional proceeding on the basis of the said audit report. Had, on the basis of the audit report, the CIT come to his own finding that the assessing authority, while making the assessment, or the authority empowered to rectify a turnover, which had escaped assessment, has acted without jurisdiction, revisional jurisdiction could have been exercised. Emphasised the Supreme Court, in the case of Sirpur Paper Mill Ltd. v. CWT [1970] 77 ITR 6, that while exercising power, the CIT must have an unbiased mind and decide the dispute according to the procedure which is consistent with the principles of natural justice and cannot permit his mind to be influenced by the dictation*

*of another authority. The relevant observations made by a three Judge Bench of the Supreme Court, in the case of Sirpur Paper Mill Ltd. (supra), read as follows (p. 7) :*

*'In exercise of the power the CIT must bring to bear and unbiased mind, consider impartially the objections raised by the aggrieved party, and decide the dispute according to procedure consistent with the principles of natural justice; he cannot permit his judgment to be influenced by matters not disclosed to the assessee, nor by dictation of another authority'."*

22. *Similar view has been taken by the Calcutta High Court in Jeewanlal (1929) Ltd. (supra) that notice issued by the CIT at the suggestion of the Audit Department without applying his mind could not be sustained in law.*

23. *In the backdrop of the above said settled legal precedents, we find that the CIT in the present case had also initiated the proceedings under s. 263 of the Act on the basis of the audit objections. Show-cause notice was issued in the present case for non-deduction of tax at source, out of certain expenses incurred by the assessee and order passed by the CIT under s. 263 of the Act directing the AO to redetermine the income of the assessee by applying a rate other than the rate applied by the AO, being without jurisdiction, is not tenable in law. We find no merit in the plea of the learned Departmental Representative for the Revenue that the source of information in the present case was audit objection, but there was independent application of mind by the CIT. The provisions of s. 263 of the Act are clear and absolute that the power is to be exercised by the CIT from the examination of the records of the proceedings under the Act. The Explanation under s. 263 of the Act defines 'records' as all records relating to any proceedings under the Act available at the time of examination by the CIT. The audit objections under no circumstances can be called as record empowering the CIT to exercise jurisdiction under s. 263 of the Act. Further it is apparent that the CIT has initiated the revision proceedings only on the basis of audit objection. Such exercise of power under s. 263 of the Act is not tenable in law. Accordingly, we set aside the order passed by the CIT under s. 263 of the Act. The grounds of appeal raised by the assessee are thus allowed.*

17. The assessee also relied on the CIT Vs. Sohana Woollen Mills (Punjab & Haryana) [296 ITR 238], wherein, the Hon'ble Punjab & Haryana High Court held as under :

*"A reference to the provisions of section 263 of the Act shows that jurisdiction there under can be exercised if the Commissioner of Income-tax finds that the order of the Assessing Officer was erroneous and prejudicial to the interests of the Revenue. Mere audit objection and because a different view could be taken, are not enough to say that the order of the Assessing Officer was erroneous or prejudicial to the interests*

*of the Revenue. The jurisdiction could be exercised if the Commissioner of Income-tax was satisfied that the basis for exercise of jurisdiction existed. No rigid rule could be laid down about the situation when the jurisdiction can be exercised. Whether satisfaction of the Commissioner of Income-tax for exercising jurisdiction was called for or not, has to be decided having regard to a given fact situation."*

18. From the above legal precedents, it is observed that for the purpose of taking up the case for revision, the Pr.CIT has to apply his mind, but not to initiate the proceedings only on the basis of audit objection. In the instant case, it is evident from the order u/s 263 that the case was taken up for revision on the basis of audit objection. The Revenue did not bring any other decision of Hon'ble Apex Court or the jurisdictional High Court to support their view. Therefore, respectfully following the decisions cited supra, we hold that the audit objection is not the basis for taking up the revision under section 263 and the Pr.CIT is not permitted to take up the case for revision only on the basis of audit objection. Respectfully following the view taken by the Hon'ble Punjab and Haryana High Court and the Coordinate Bench of ITAT Chandigarh, we are unable to sustain the order of the Ld.Pr.CIT and accordingly, we set aside the order of the Ld.Pr. CIT and allow the appeal of the assessee.

19. Since we have decided the appeal in favour of the assessee on application of section 56(2)(vii)(c) of the Act in case of close relatives and on audit objection, we consider it is not necessary to adjudicate the

remaining grounds/ propositions put forth by the Ld.AR during the appeal hearing. Accordingly, the appeal of the assessee is allowed.

20. In the result, appeal of the assessee is allowed.

Order pronounced in the open court on 7<sup>th</sup> December , 2018.

Sd/-

(वी.दुर्गा राव)

**(V. DURGA RAO)**

न्यायिक सदस्य/**JUDICIAL MEMBER** लेखा सदस्य/**ACCOUNTANT MEMBER**

विशाखापटणम /Visakhapatnam

दिनांक /Dated :07.12.2018

L.Rama, SPS

Sd/-

(डि.एस. सुन्दर सिंह)

**(D.S. SUNDER SINGH)**

आदेश की प्रतिलिपि अग्रेषित/Copy of the order forwarded to:-

1. अपीलार्थी / The Appellant – Sri Kumar Pappu Singh, D.No.23-3-26, Sundaram Nagar, Sajjapuram, Tanuku
2. प्रत्यार्थी / The Respondent– Dy.Commissioner of Income Tax, Circle-1, KKS Towers, RR Pet, Eluru, Andhra Pradesh
3. The Pr.Commissioner of Income Tax, Rajahmundry
4. विभागीयप्रतिनिधि, आयकरअपीलीयअधिकरण, विशाखापटणम /DR, ITAT, Visakhapatnam
5. गार्डफ़ाईल / Guard file

आदेशानुसार / BY ORDER

// True Copy //

Sr. Private Secretary  
 ITAT, VISAKHAPATNAM