

**IN THE INCOME TAX APPELLATE TRIBUNAL**

**“A” BENCH : BANGALORE**

**BEFORE SHRI A. K. GARODIA, ACCOUNTANT MEMBER  
AND  
SHRI LALIET KUMAR, JUDICIAL MEMBER**

**ITA No.2880/Bang/2018  
(Assessment year : 2015 – 16)**

M/s. 2M Power Health Management Services Pvt. Ltd.,  
No. 614, 3<sup>rd</sup> Cross, 3<sup>rd</sup> Block,  
Koramangala,  
Bangalore – 560034.  
**PAN. AAACZ3783E**

Appellant

Vs

The ITO, Ward – 7 (1) (2),  
Bangalore.

Respondent

**Assessee by : Shri Sharath Rao, C. A.**

**Revenue by : Shri C. H. Sundar Rao, CIT (DR)**

**Date of hearing : 10 – 12 – 2018**

**Date of pronouncement : 21– 12 – 2018**

**ORDER**

**PER A. K. GARODIA, A.M.:**

This appeal is filed by the assessee which is directed against the order of CIT (A) – 7, Bangalore dated 03.08.2018 for A. Y. 2015 – 16.

2. The grounds raised by the revenue are as under:-

*“The following grounds of appeal are independent of, and without prejudice to one another:*

*1. Taxation of excess share premium received as income from other sources under section 56(2)(viib) of the Income-tax Act, 1961 [‘the Act’]*

*1.1. Appellant's choice of method of valuation as per law*

*a) The learned Commissioner of Income-tax (Appeals) [‘CIT(A)’] erred in upholding the order of the Assessing Officer [‘AO’] and confirming his action of bringing the share premium to tax under section 56(2)(viib) of the Act.*

*b) The learned CIT(A) failed to appreciate that:*

- Rule 11UA(2) of the Income-tax Rules, 1962 [‘Rules’] has explicitly conferred an option upon the tax payer to adopt any of the methods either Net Asset Value [‘NAV’] method under Rule 11UA(2)(a) of the Rules or Discounted Cash Flow [‘DCF’] method under Rule 11UA(2)(b) of the Rules for*

*valuation of shares for the purpose of section 56(2)(viib) of the Act; and*

- *The Appellant had opted DCF method of valuation to determine the fair value of the unquoted compulsorily convertible preference shares ['CCPS'] by obtaining a Valuation Report from an accountant ['CA'].*

#### *1.2. Reliance on expert's report*

*a) The Learned CIT(A) erred in not placing reliance on the valuation report obtained by the Appellant from a CA for determination of value of shares, which is the requirement prescribed by Rule 11(2)(b) of the Rules.*

*b) The CIT(A) erred in alleging that:*

- *The CA made a tailor-made report to suit the requirement of the management; and*
- *No scientific method had been employed for determining the valuation of shares and the CA had considered unverified exorbitant future cash flows which led to inflated value of shares.*

#### *1.3. Comparison of projected figures with actuals is unwarranted*

*a) The learned CIT(A) erred in making an arbitrary comparison between the projected numbers of revenue and profit along with the actual figures and challenging the sanctity of the projections.*

*b) The learned CIT(A) failed to take cognizance of the fact that the valuation report obtained by the CA was based on several factors [macro and micro] like Company's future business objectives, expansion plans, industry, economic scenario, customer sentiments, etc. prevalent at the time of drawing such forecasts and these could not have been compared with the actuals to expect the same figures as were anticipated in the past.*

*c) The learned CIT(A) failed to appreciate that:*

- *The Appellant was incorporated in 2009 and had initially introduced 2 line of business activities in the health care sector; given the competitive market conditions, it decided to drop one of its business lines;*
- *The projections were drawn based on future expectations w.r.t both the business lines and comparison with actual numbers, when one of the business line was dropped off is incorrect and unreasonable.*

#### *1.4. AO/ CIT(A) to have sound reasoning before rejecting the Appellant's method of valuation and introducing his own*

*a) The learned CIT(A) erred in entirely disregarding the valuation method itself adopted by the Appellant and hence disregarding the legislative intent.*

*b) The learned CIT(A) failed to appreciate that the option to choose valuation methodology for unquoted shares i.e. NAV*

*method under Rule 11UA(2)(a) of the Rules or DCF method under Rule 11UA(2)(b) of the Rule lies with assessee.*

*c) The learned CIT(A) failed to appreciate that by permitting the AO to adopt a valuation method of his choice and force his option upon the assessee, the provisions of Rule 11UA(2)(b) would be rendered as nugatory and purposeless.*

*d) The learned CIT(A) erred in accepting the amounts of assets and liabilities arbitrarily arrived at by the AO for the purpose of determining the value of shares.*

*e) The learned CIT(A)/AO failed to demonstrate as to how the valuation report was unreliable and did not point out any particular error in the valuation report/ any amount that was incorrect/ imaginary/ tailor-made before disregarding the valuation methodology adopted by the Appellant.*

#### *1.5. Valuation of preference shares different from equity shares*

*The CIT(A) erred to appreciate that the valuation method employed to determine the value of unquoted equity shares cannot be applied to unquoted preference shares since:*

*a) Preference shareholders get preference over equity shareholders in terms of payment of dividend and repayment of equity and hence, the NAV of the Company represents the value of equity shares and not preference shares;*

*b) Preference shares are 'quasi-debt' instruments, they stand on a different footing from equity shares and hence, the tests applied to equity shares could not be arbitrarily applied to preference shares.*

*The Appellant craves leave to add, alter, rescind and modify the grounds herein above or produce further documents, facts and evidence before or at the time of hearing of this appeal.*

*For the above and any other grounds, which may be raised at the time of hearing, it is prayed that necessary relief may be provided."*

3. Brief facts are that the AO has noted on page 2 of the assessment order that the assessee company has allotted 36,000 Compulsory Cumulative Convertible Preference Shares (CCCPS) at a premium of Rs. 490/- per share to various 7 parties. After noting this, he invoked the provisions of section 56 (2) (viib) of the I. T. Act. He also referred to Rule 11UA (2) of Income Tax Rules, 1962 and thereafter, he referred to valuation report of M/s JBN Associates, Chartered Accountants dated 31.03.2014, which was obtained by the assessee for valuation of shares as per DCF method at Rs. 516/- per share on the basis of management certified future cash flow statement. The AO was of the opinion that this certificate obtained by the assessee from the said C. A. is a self serving document because the valuation has been done by the CA on the

basis of projections made and certified by the management. The AO issued a show cause notice to the assessee on 24.11.2017 in this regard. The same was replied by the assessee but the AO was not satisfied and he held that as per Rule 11UA (2) (a), the fair market value of each share is Rs. 56.17 and since, share premium was received @ Rs. 490/- per share, he made addition of Rs. 156,17,880/-. Being aggrieved, the assessee carried the matter in appeal but without success and now, the assessee has filed this appeal before the tribunal.

4. In course of hearing, it was submitted by the learned AR of the assessee that in the present case, the valuation is to be done of preference shares and not equity shares and therefore, sub clause (c) of sub rule (c) of Rule 11UA (1) is applicable and as per the same, these shares are to be valued at a price it would fetch if sold in open market. He further submitted that copy of written submissions filed by the assessee before CIT (A) is available on pages 103 to 112 of the paper book and in particular, our attention was drawn to page 108 of the paper book and it was pointed out that it was submitted by the assessee before CIT (A) that sub clause (c) of Rule 11UA (1) (c) is applicable in the present case but in spite of this, there is no decision of CIT (A) on this aspect as per the impugned order and therefore, the matter may be restored to his file for a fresh decision after deciding this aspect. Learned DR of the revenue supported the order of CIT (A).
5. We have considered rival submissions and gone through the material available on record. We find that in the written submissions filed by the assessee before CIT (A), copy available on pages 103 to 112 of the paper book, it was submitted by the assessee that sub clause (c) of sub rule (c) of Rule 11UA (1) is applicable. The basis of valuation prescribed in this sub clause (c) of sub rule (c) of Rule 11UA (1) is entirely different than other sub clauses (a) and (b) of sub rule (c) of Rule 11UA (1) and Rule 11UA (2). In this regard, we also notice that as per a sample Letter of Offer" the preference shares in question dated 31.07.2014 copy available on pages 129 to 130 Additional Evidence, as per Para 1 (e), it has been stated that the said preference shares shall have a right to attend general meeting of the company and vote on resolutions directly affecting their interest. In our considered opinion, the only main difference in the

rights of a holder of an equity share and preference share is this that the holder of preference share does not have voting right. But in the present case, as per this para of the offer letter, the holder of a preference share is provided with voting right also and therefore, can it be said that the nature of the share issued in the present case is actually that of an equity share and not preference shares but this evidence is brought on record as an additional evidence and there is no comment of any of the authorities below on it. Hence, in our considered opinion, this aspect of the matter should be decided first as to which Rule/Sub Rule/ sub clause is applicable in the facts of the present case and thereafter, the matter should be decided as per the applicable Rule/Sub Rule/ sub clause. All the terms of the issue of preference shares have to be looked into for this purpose to find out whether the present receipt of share premium is for issue of preference shares or for issue of equity shares because even if it is found that because of limited voting right only, the said shares are not equal to equity shares, then also, this is important to note that ultimately, these preference shares are to be converted into equity shares after a fixed time at a fixed rate and hence, this is important to find out as to whether the premium received is for equity shares to be issued later or for preference shares issued now since ultimately, these preference shares are compulsorily to be converted in to equity shares. If it is found that the premium received is mainly for conversion of preference shares into equity shares at an agreed price after an agreed time than there may be a case of non applicability of sub clause (c) of sub rule (c) of Rule 11UA (1). These details are not available in the paper book and even if some things are available, the same are in the form of additional evidence without any comment of the lower authorities and explanation of the assessee and hence, we cannot decide this aspect. Hence, we feel it proper to restore the matter to the CIT (A) for a fresh decision on this issue after deciding this aspect first that in the facts of the present case, which Rule/Sub Rule/ sub clause of Rule 11UA is applicable in the light of above discussion. Thereafter he should decide the quantum of permissible share premium. If it is held that sub clause (c) of sub rule (c) of Rule 11UA (1) is applicable, than the acceptable value as per the same has to be worked out and if it is ultimately held that DCF method is to be adopted as prescribed under Rule 11UA (2) (b),

than the assessee has to establish that the projections given by the management to the chartered accountant for his certificate are on a scientific basis because the said Chartered Accountant has adopted those projections without commenting anything on its acceptability. Hence, only those projections of cash flow should be adopted which are based on a scientific basis. In respect of estimation of something for future, the estimation has to be on a scientific basis. This view of us is supported by the judgments of Hon'ble Apex court rendered in the case of Rotork Controls India (P) Ltd. as reported in 314 ITR 62 and in the case of Bharat Earth Movers vs. CIT as reported in 245 ITR 428. In both these cases, the dispute was regarding estimation of future liability on account of warranty provisions and leave encashment respectively and it was held that it should be capable of being estimated with reasonable certainty though actual quantification may not be possible. In the present case, estimation is to be made of future cash flow and hence, the assessee has to establish that estimation made by the management and given to the Chartered Accountant for certifying DCF is estimated by the management on a scientific basis and therefore, the said estimate is made with reasonable certainty. If such estimation with reasonable certainty is not found possible than this method cannot be adopted on the basis of those data which are not estimated with reasonable certainty. In that situation, other methods have to be adopted.

6. In the result, the appeal of the assessee is allowed for statistical purposes.

Order pronounced in the open court on the date mentioned on the caption page.

Sd/-  
(LALIET KUMAR)  
Judicial Member

Sd/-  
(ARUN KUMAR GARODIA)  
Accountant Member

Bangalore,  
Dated, the 21<sup>st</sup> December, 2018.  
/MS/

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore
6. Guard file

By order

Assistant Registrar,  
Income Tax Appellate Tribunal,  
Bangalore.