

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'F' NEW DELHI**

**BEFORE SHRI R. K. PANDA, ACCOUNTANT MEMBER
AND
MS SUCHITRA KAMBLE, JUDICIAL MEMBER**

ITA No. 7505/DEL/2018 (A.Y 2014-15)

Regal Buildtech P. Ltd. 2/48, Shopping Centre, Malcha Marg, New Delhi AACCR9566P (APPELLANT)	Vs	ACIT Circle-21(1) New Delhi (RESPONDENT)
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Appellant by	Sh. Ajay Wadhwa, Adv, Ms. Aushi Gupta, CA
Respondent by	Smt. Sulekha Verma, CIT(DR)

Date of Hearing	31.05.2019
Date of Pronouncement	18.06.2019

ORDER

PER SUCHITRA KAMBLE, JM

This appeal is filed by the assessee against the order dated 9/10/2018 passed by CIT(A)-7, for Assessment Year 2014-15.

2. The grounds of appeal are as under:-

1. *"The order of the Commissioner of Income Tax (Appeals) - 7, Delhi (referred to as "CIT(A)") is bad in law and on facts.*
2. *That the A.O. / CIT(A) has erred in law and on facts in substituting himself as an expert on valuation of shares in contradiction to the valuation expert and questioning the valuation report issued by the prescribed valuer "Chartered Accountant" as per Rule 11UA(2)(b) of the Income Tax Rules, 1962*

without understanding the valuation method prescribed viz Discounted Cash Flow(DCF) method.

3. *The CIT(A) has erred in law and on facts in failing to appreciate the fact that the queries raised by the assessing officer in respect of the valuation report were duly directed to the Chartered Accountant who in turn responded with complete clarifications. The appellant also furnished the report of another independent Chartered Accountant who valued the shares based on the observation of the AO by factoring interest costs on loans. Without taking cognizance of the second valuation report the AO/CIT(A) dismissed the valuation of an expert based on presumption, suppositions, generalities and assumptions.*

4. *That the AO/ CIT(A) has erred in law and on facts in stating that the projections in the valuation report are contrary to the existing state of affairs of the company.*

5. *The CIT(A) has erred in law in rejecting the valuation using DCF method of an expert and thereafter substituting his own valuation by adopting the net asset value of the shares whereas option of selecting method between NAV or DCF was with the appellant in accordance with rule 11UA(2) of Income Tax Rule, 1962. This is grossly illegal and the CIT(A) has exceeded his jurisdiction.*

6. *The CIT(A) has erred in law and on facts in failing to appreciate that the intent and purport of this section was to check the malaise of accommodation entries. In the case of the appellant the directors own funds have been received through holding company and right shares issued to the holding company and therefore there can be no allegation of any malaises or accommodation entry operation. The Ld. CIT (A) failed to appreciate that it did not matter whether the shares were issued to the holding company at par or at premium since the entire money received by the appellant was from its holding company, which had in turn received the money from the directors.*

7. *The CIT(A) has erred in law and on facts in holding that the issue of shares does not constitute a right issue as the shares were not offered on a proportionate basis to the existing shareholders. Therefore, according to the CIT(A) the ratio of the Bombay Tribunal in the case of Sudhir Menon HUF Vs. ACIT(2014) 45 taxmann.com 176 is not applicable.*

8. *The AO/CIT(A) has also erred in applying the explanation to the section 56(2)(viib) of the Act, which is as under-*

"(a) the fair market value of the shares shall be the value—

(i) as may be determined in accordance with such method as may be prescribed;

or

(ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of its assets, including intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, whichever is higher;"

The value of the shares is clearly justifiable based on the value of the property held by the assessee company in the form of a Mall. The value of Mall itself justifies the value of shares on the date of issue and the case of the appellant clearly falls under sub clause (ii) of the explanation (a) reproduced above.

9. *The CIT (A) has erred in law and on facts in failing to appreciate that the addition of Rs. 20,30,00,000/- was made under section 56(2)(vii)(b) which is applicable only to individuals and HUF and therefore, the order of the assessing officer is without jurisdiction. The CIT(A) has erred in holding that the addition made under the said section constitutes only a typographical mistake, which is curable under section 292B of the Income Tax Act, 1961.*

10. *The Appellant Company craves leave to add/alter/amend the grounds of*

Appeal at the time of hearing.”

3. The assessee e-filed its return of income on 30.09.2014 for Assessment Year 2014-15 declaring loss of Rs. 4,09,87,384/-. The case was selected for scrutiny. During the year under consideration, the assessee declared receipt of share premium amounting to Rs.40.60 crores. The assessee had issued 14 lakh shares of face value of Rs.10 per share to its existing share holders, namely M/s Prime Land Real Estate (P) Ltd. & M/s Eureka Ventures Foundation, during the year at a premium of Rs.290/- per share. During the course of assessment proceedings, the assessee was asked to justify the share premium charged on issue of shares issued during the year and to furnish a valuation certificate in support thereof. The assessee furnished replies vide letter dated 08.07.2016 and 30.11.2016 and enclosed copy of share valuation certificate dated 17.06.2013 issued by M/s Uberoi Sood Kapoor, CAs. The valuation was carried out based on Discounted Cash Flow method. The value stated in the aforesaid certificate that the share valuation of the assessee company was based on the cash flows of the mall. The Assessing Officer observed that cash inflows are projected rental income while cash outflow are calculated only on account of property tax, miscellaneous expenses and LLP loss. From the value of the enterprise thus worked out, loans have been deducted to arrive at the equity value of the company. However, a perusal of the account of the assessee and computation of income for the year under consideration reveals that the assessee has been consistently reported heavy losses. A significant cost in respect of the property was the interest expenses on capital borrowed for construction which, for the year under consideration was Rs.3.83 crores, if such interest is considered, the net cash flows from property becomes negative. The cash flows projected by the assessee company are also found to be completely at variance with the projection used for DCF method. The Assessing Officer further observed that the valuation done by the accountants suffers from the defect that it does not take into account the significant financial outflow on account of interest on capital borrowed for

construction of the property. If such cost were considered there would be net cash out flow and valuation would realistically reflect the perpetual losses being reported by the assessee. The assessee was asked to explain why such interest expenses were not taken into account for calculation of equity value. The assessee furnished an explanation dated 23.12.2016 from M/s Uberoi Sood Kapoor, CAs, to the effect that had such interest been taken into account the equity value would be even higher. The necessary figures in the calculation were also perused. However, such projections are also not borne out by any verifiable data and the calculation appears to be an afterthought designed to offset the query made, the projected cash flows have also been adopted without any rational or clear basis and contrary to the existing state of affairs of the company. The valuation has been inflated intentionally to raise security premium and to defeat the intention behind enactment of Section 56(2)(viib) of the Act. In view of the above discussion, the Assessing Officer held that the share premium amount of Rs.20,30,00,000/- received from M/s Primeland Real Estate P. Ltd. shall be brought to tax as income u/s 56(2)(viib) of the Act. Thus, order u/s 143(3) was passed on 31/12/2016 by the Assessing Officer, assessing the income at Rs.16,20,12,620/- after addition of Rs.20,30,00,000/- u/s 56(2)(viib) of the Act.

4. Being aggrieved by the assessment order, the assessee filed appeal before the CIT(A). The CIT(A) dismissed the appeal of the assessee.

5. The Ld. AR submitted that the basis of taking the projected figures were clarified to the Assessing Officer during the course of assessment proceedings through a letter of valuer dated 16.12.2016. The Assessing Officer did not consider such letter. The clarification letter was again furnished before the CIT (A) vide submissions dated 07.07.2017. Valuer accountant had not merely prepared the report based on the projected figures provided by the client, but also mentioned that he had carried out the analysis of the information. For that he had relied on the published and the secondary data. Published and

secondary data was referred in the clarification letter dated 16/12/2016. The scope of work and the limitations mentioned in the report given by the valuer is the reporting requirements and for the compliance with the professional standards of the valuer. In the reporting requirements of the "Technical guide issued by the ICAI on Share Valuation published in 2009" specifically provides such limiting conditions. As per Clause (3) Part I of Second Schedule to Chartered Accountants Act, 1949 "A CA in practice is deemed to be guilty of professional misconduct if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast." Further as per *SRE-3400*, "The Examination of Prospective Financial Information" issued by the Institute of Chartered Accountants of India - provides that the management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purpose. Thus, while making report on projection, the auditor need to mention that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same'. The Ld. AR submitted that these scope and limitations are not the qualification/opinion. The valuation report of the valuer is not the Financials which require any qualification. These are statutory compliances. The Ld. AR submitted that the Revenue alleged that valuation report suffers from defects as not considered the interest cost. There are two approaches in DCF method to calculate the free cash flows (a) Free Cash flows to the Firm - Cash flows after meeting all the operating cash expenses but prior to debt payments; (b) Free Cash Flows to Equity - Cash flows after meeting all the operating expenses, interest and

principal payment of debt. When the cash flows are calculated for the firm/enterprise, the entire value of the debt has to be reduced from the value of the enterprise to arrive at the value of equity shareholders. When the cash flows are calculated for the firm/enterprise, the entire value of the debt has to be reduced from the value of the enterprise to arrive at the value of equity shareholders. In the valuation report dated 17.06.2013, the valuer had determined the value of shares by taking into consideration free cash flows to the firm and then reduced the value of debt to arrive at the value of equity. Further it is very logical that if the entire loans have been reduced at Zero period, how the interest would arise in future. The Ld. AR submitted that the Revenue alleged that projected figures are not verifiable. During the course of assessment proceedings the assessee had provided the clarifications dated 16.12.2016 regarding from where the projected figures were taken. Projected cash flows were based on the various reports/data gathered by the analyst and management and analysed and verified by the valuer as clarified in the statement referred above. The Assessing Officer did not consider such clarification statement while completing the assessment.

6. The Ld. AR further submitted that free cash flows to the firm were calculated by the valuer for the calculation of NPV. Free cash flows to the firm are calculated after deducting the operating expenses but before the interest and repayment of debt. NPV was calculated using the free cash flows to the enterprise, the interest expenses was not reduced. In DCF method of determining the value of shares, projections are based on the credible data. The valuer had reduced the entire amount of loan from the enterprise value to arrive at the value of equity shareholders as per the requirement of the method as prescribed in the International Standards and guidelines issued by the ICAI. Neither the valuer nor the management had stated anywhere that the loans have been paid off, but the method was to arrive at the value of equity by reducing the loans. It was an assumption that the cash flows will generate infinitely. Estimation of stable growth rate till perpetuity is of great

significance. Ideally perpetuity growth rate should not be more than the expected economic growth rate. Growth rate has been assumed by the valuer after analysing the industry growth rate, (growth rate was determined after analysing the reports published by the Indian Brand Equity Foundation). Various factors and published data have been considered for determining the growth rate for calculating the terminal value. Valuer had after considering the various reports and the industry growth rate conservatively taken 5%. The projection of the occupancy and rentals were based on the data provided by the client, which was based on the similar Mall located within 2km. of the Pulse Mall. Further, when the occupancy of mall will increase that will also increase the footfall, which ultimately increase the turnover of the tenants. Since, the rent was also based on the turnover of the tenants, it would automatically increase. Occupancy and the rental are the two different factors and cannot be interchanged with each other. Hence the CIT (A) has erred in stating that the valuer had considered the two dimensional growth rate. Discount rate actually represents the time value of money for a certain cash flow. It is the representation of the interest rate that could get on a similar investment elsewhere. Capitalasset pricing model (CAPM) was used to arrive at the discount rate of 15%. The growth rate has been added to the capitalization rate to arrive at the discount rate for the future cash flows. "Higher the interest rate lesser will be the NPV and vice-versa" - It is the basic principal of time value of money. In the opinion of management and valuer the resulted rate of 15% is the correct representative of the company's discounting factor. Rate has been simply derived by applying the formulas. Further the cash flows generated would not received by the appellant only at the last day of the year. It would have been received over the period. For determination of correct NPV, valuers has taken the scientific and approved method i.e., average of the days in a year and arrive at the dates at which the rate was applied. The CIT(A) has taken the last day of the year for applying the discount rate to calculate the NPV. Loan reduced at the Zero period is only for the purpose of calculating the equity value as already discussed above and it did not mean that the loans have

actually been paid off. This valuation report has been prepared by using Free Cash Flows to Equity, in which periodical interest and loan repayments have been considered and was obtained during the assessment proceedings to satisfy the Assessing Officer. Repayment of loans has been taken as per the repayment schedule provided by the management. The loan repayment chart of the management consists of the repayment of (a) Bank loan; (b) Redemption of debenture; and (c) inter corporate loans. Repayment of bank loan was taken as per the bank repayment schedule. Repayment of debentures were taken as per the redemption terms. And Repayment of incorporate loans were taken at the 5th year. Reason for the spiked up figure of repayment in second year was the redemption of the debentures as per the terms of redemption. Loans were reduced on the date of valuation by the valuer to calculate the NPV. The valuer had applied the method to arrive at the NPV as required by the Assessing Officer. Sources were not required to explain to apply the method. Same as given in point No. 3 of assessee's contention before the CIT(A). The CIT(A) has erred in stating that no clarification letter was produced/ furnished before him/ Assessing Officer. The letter dated 16.12.2016 was furnished before the Assessing Officer and again before the CIT(A) vide submissions dated 07.07.2017. During the course of assessment or appellate proceedings the Assessing Officer and the CIT(A) did not asked any further clarification or document and the assessee was of the view that they were satisfied with the clarification given. The allegation of the CIT(A) that the assessee did not furnish such clarification or the documents referred therein is not factually correct. (A) Extract of the certificate - regarding projected cash flow statement; There was such extract in the valuation report dated 22.12.2016. There are only 2 annexures of the valuation report dated 22.12.2016, Annexure- A and Annexure - B. All the date considered for the valuation was verified by the valuer.

7. The Ld. AR further submitted that for the projection of the lease rentals the valuer had analysed various published and secondary data available at that

time and also data provided by the client. During the course of proceedings the assessee had referred the data analysed and verified by the valuer vide letter dated 16.12.2016 but neither the Assessing Officer nor the CIT(A) had given due consideration to the clarifications of the assessee and had never asked for any data to furnish before them. The assessee had furnished the clarification regarding the market research report of analyst vide its letter dated 16.12.2016. Neither the Assessing Officer nor the CIT(A) had given due consideration to the clarifications of the assessee during the course of assessment as well as appellate proceedings. If the AO or the CIT(A) had ever asked to furnished the data, the assessee definitely would provide the clarification in this regard. No further query by the CIT(A) led to the assumption that he understood the basis and did not need any further detail. Further, various other factors and data have also been considered by the valuer for determining the value of share, but it is not possible for the valuer to mention or to describe each and every report or data he analysed. Valuation is not mechanical process, which everyone can use. It requires so much of professional judgment. Even the valuation of different valuers can differ because of the estimations and the professional judgment involved. In Para 9.1.1 of the order referred by the CIT(A) that "if the valuation is not based on relevant material, the adjudicating authority can interfere with the same." while referring the Supreme Court judgment. In the present case, the material used for the purpose of calculation were never examined by the CIT(A). Then how the CIT (A) could reach at the conclusion that the valuation suffers from defects. Adjudicating authority can interfere with the valuations when it was not based on the relevant material. The Ld. AR submitted that here the adjudicating authorities never examine the material used. In the judgment of Supreme Court referred in Para 9.1, conclusion was based on the material - whether the material was relevant or not. Thus, the Ld. AR submitted that the Assessing Officer has not only a right but he is also duty bound to examine the valuation report evaluate it and record his findings on the same. Such finding should be based on relevant material and rational view taken in a judicious manner. The

CIT(A) never examined the material.

8. The Ld. AR submitted that Section 56(2) (viib) does not apply in the cases where right shares were issued by the assessee. The assessee had offered the right shares to the existing shareholders of the company proportionate to the existing shareholding of the shareholders. M/s Primeland Real Estate Pvt. Ltd.(Holding Company) had subscribed the right issue to the extent of the 7,00,000/- shares and permitted the appellant company to offer its remaining shares to the other existing shareholders of the company, if the board desired to offer them to another shareholders. The board of the assessee company had decided to allot the remaining shares to M/s Eureka Ventures as it had subscribed for the higher no. of shares. The provisions of section 56(2)(vii) are not attracted in cases where right shares were issued to the existing shareholders on proportionate basis. The Ld. AR relied upon the following judgments wherein it was held that in case of right issue provisions of section 56(2)(vii) would attract.

- (i) ACIT Vs. Sudhir Menon [2014] (45 taxmann.com 176) (Mumbai-Trib)
- (ii) ACIT Vs. Subodh Menon [2015] [ITA No. 676/mum/2015](Mumbai-Trib.)
- (iii) DCIT Vs. Dr. Rajan Pai [2016] (82 taxmann.com 347) (Banglore-Trib.)
- (iv) Kumar Pappu Singh Vs. DCIT [2018](101 taxmann 122)
(Vishakhapatnam Trib.)

The Ld. AR further submitted that valuation report of expert can only be disputed on the basis of the valuation report of another expert. As per the explanation to the section 56(2)(viib) of the Act, the fair market value shall be the value

- (i) As may be determined in accordance with such method as may be prescribed; or
- (ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of its assets, including intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, Whichever is higher;

The Ld. AR further submitted that the prescribed method under clause (i) is Rule 11UA(2) of the Income Tax Rules. Sub rule (2) of rule 11UA specifically provides the method for determining the fair market value of shares. The assessee had adopted the option (b) of the rule 11UA(2) of the Income Tax Rules, which provides as under:

"(b) the fair market value of the unquoted equity shares determined by a merchant banker or an accountant as per the Discounted Free Cash Flow Method."

The assessee company had engaged an accountant (Chartered Accountant) who determined the value of equity share as per the DCF method prescribed under the rule for the purpose of making the right issue. During the course of proceedings before the lower authorities, both the Assessing Officer as well as CIT(A) had found faults in the valuation report made by an expert and made his own valuation. The Assessing Officer and the CIT(A) has failed to appreciate that as required by the law the valuation made by the expert can only be disputed based on the valuation report made by another expert and therefore, the valuation made by the CIT(A) presuming himself being an expert in the field of valuation was not in accordance with the law. The Assessing Officer as well as the CIT(A) both certainly could not understand the valuation method prescribed under the rule 11UA(2)(b) i.e. DCF method and found out various discrepancies in the valuation report submitted by the assessee which was

made by an expert , Chartered Accountant. In fact, the CIT(A) considered himself an expert and made his own valuation which was not as per the valuation method prescribed under the Act. The Ld. AR relied upon the following decisions:

- Rameshwaram Strong Glass (P) Ltd. Vs. Income-tax Officer [2018] (96 taxmann.com542)
- Assistant Commissioner of Income-tax, Mumbai Vs. Koch Chemical Technology Group(India) Ltd. (2015) (64 taxmann.com 464)
- Smt. Suman Goelvs. Income Tax Officer [2013] (1SOT 127)
- M/s Ozoneland Agro Pvt. Ltd. [ITA No. 4854/Mum/2016}

9. The Ld. DR relied upon the Assessment Order and the order of the CIT(A). The Ld. DR also relied upon the following decisions:-

- ❖ Sunrise Academy of Medical Specialties (India) (P) Ltd. Vs. ITO 94 taxmann.com 181 order dated 22/5/2018. Kerala High Court
- ❖ Pr. CIT(A) Vs. NDR Promoters Pvt. Ltd. ITA No. 49/2018 dated 17/1/2019. (Del. HC)
- ❖ Sonia Gandhi Vs. ACIT , W.P (C) 8482/2018, dated 10/9/2018. (Del. HC)
- ❖ J. B Boda & Co. (P) Ltd. Vs. CBDT 223 ITR 271 dated 30/10/1996 (SC)

10. We have heard both the parties and perused the material available on record. It is pertinent to note that the Assessing Officer as well as the CIT(A) observed that projected figures are not verifiable. But during the course of assessment proceedings, the assessee had provided the clarifications dated 16.12.2016 as to from where the projected figures were taken. As per the

contentions of the Ld. AR, the projected cash flows were based on the various reports/data gathered by the analyst and management and after analyzing and verifying the same by the valuer. But the same was not considered either by the Assessing Officer as well as by the CIT(A). From the records it can be seen that the Assessing Officer as well as the CIT(A) never asked for furnishing the data from the Assessee at any point of time. Thus, they have not given any opportunity to the assessee to further clarify the projected cash flows. It is agreed that valuation is not mechanical process but, determined from market trends and other factors and after considering them, the valuer can determine the value of share. Even if the said is doubted, the Assessing Officer should have given proper opportunity to the assessee for allowing the assessee to clarify the aspects of the valuation of the projected cash flow, which the Assessing Officer failed to do so as well as the CIT(A) also did not take into account the submissions made by the Assessee. Thus, it will be appropriate to remand back all the issues contested herein to the file of the Assessing Officer with a direction to decide the same afresh after verifying all the relevant aspects of the valuation method regarding projected cash flow and arrive at a reasoned conclusion. Needless to say, the assessee be given proper opportunity of hearing by following principles of natural justice. Thus, appeal of the assessee is partly allowed for statistical purpose.

11. In result, the appeal of the assessee is partly allowed for statistical purpose.

Order pronounced in the Open Court on 18th June, 2019.

**Sd/-
(R. K. PANDA)
ACCOUNTANT MEMBER**

**Sd/-
(SUCHITRA KAMBLE)
JUDICIAL MEMBER**

Dated: 18/06/2019
R. Naheed

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR
ITAT NEW DELHI

Date of dictation	31.05.2019
Date on which the typed draft is placed before the dictating Member	03.06.2019
Date on which the typed draft is placed before the Other Member	
Date on which the approved draft comes to the Sr. PS/PS	
Date on which the fair order is placed before the Dictating Member for pronouncement	
Date on which the fair order comes back to the Sr. PS/PS	18.06.2019
Date on which the final order is uploaded on the website of ITAT	18.06.2019
Date on which the file goes to the Bench Clerk	18.06.2019
Date on which the file goes to the Head Clerk	
The date on which the file goes to the Assistant Registrar for signature on the order	
Date of dispatch of the Order	