

IN THE INCOME TAX APPELLATE TRIBUNAL  
“B” BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT  
AND SHRI B R BASKARAN, ACCOUNTANT MEMBER

ITA No.161/Bang/2020
Assessment year : 2013-14

Taaq Music Pvt. Ltd., # 912, GKR Towers, 80 Feet Road, 6 <sup>th</sup> Block, Koramangala, Bangalore – 560 095. <b>PAN: AADCT 1127F</b>	Vs.	The Income Tax Officer, Ward 7(1)(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Balram R. Rao, Advocate
Respondent by	:	Shri Priyadarshi Mishra, Jt.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	03.09.2020
Date of Pronouncement	:	28.09.2020

**ORDER**

*Per N.V. Vasudevan, Vice President*

This appeal by the Assessee is against the order of the Commissioner of Income Tax (Appeals)–7, Bangalore, dated 10-12-2019 in relation to assessment year 2013-14.

2. The only issue involved in the appeal is as to whether the revenue authorities were justified in invoking provisions of section 56(2)(viib) of the Income Tax Act, 1961 (the Act) and bringing to tax the difference between the fair market value and the issue price of shares at a premium as income of the Assessee. Section 21 clause (B) of Finance Act, 2012 introduced Sec.56(2)(viib) of the Act with effect from the 1st day of April, 2013, and the said provisions reads thus:-

“Income from other sources.

56. (1) Income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head "Income from other sources", if it is not chargeable to income-tax under any of the heads specified in section 14, items A to E.

(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head "Income from other sources", namely :—

(i) ..... (viiia).....

(viib) where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares:

Provided that this clause shall not apply where the consideration for issue of shares is received—

(i) by a venture capital undertaking from a venture capital company or a venture capital fund; or

(ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf.

Explanation.—For the purposes of this clause,—

(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;

(b) "venture capital company", "venture capital fund" and "venture capital undertaking" shall have the meanings respectively assigned to them in clause (a), clause (b) and clause (c) of Explanation to clause (23FB) of section 10;"

3. Section 56(2)(viib) of the Act was introduced by the Finance Act 2012 with effect from the 1st day of April, 2013, which requires a Company (issuer), not being a company in which the public are substantially interested, to issue shares at Fair Market Value (FMV). Any consideration received by such issuing Company in excess of the FMV, to the extent it exceeds the face value of such shall be liable to tax. For the purpose of this section, FMV shall be the value, Higher of the following:-

“(a) as may be determined in accordance with such methods as may be prescribed( Methods prescribed under Rule 11UA are Book value Method (NAV) and Discounted Cash flow method); or

(b) 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,”

4. The Assessee is in the business of providing education in music. The Assessee entered into a share subscription and shareholders agreement dated 11.12.2011 for issue of shares. The Assessee received a sum of Rs.82 lacs by 31.3.2012 towards share application money. During the previous year i.e., on 21.11.2012, the Assessee issued and allotted 146 shares of Rs.100 each at a premium of Rs.92,47,480/- (premium of Rs.63,338.90).

5. The first plea of the Assessee was that consideration for issue of shares was received in the previous year relevant to AY 2012-13. The Assessee took a plea that the provisions of Sec.56(2)(viib) of the Act were introduced by the Finance Act, 2012 w.e.f. 1.4.2013 and therefore those provisions were not applicable. This plea was rejected by the AO by observing that though the Assessee received of major portion of consideration for shares in the previous year relevant to AY 2012-13, the sum so received was in the nature of Share Application Money pending allotment and the issue of shares was the relevant point of time for application of the provisions of Sec.56(2)(viib) of the Act. The shares were allotted in the previous year relevant to AY 2013-14 and therefore the provisions of Sec.56(2)(viib) were applicable to the case of the Assessee. The CIT(A) concurred with the view of the AO. We are in agreement with the view of the revenue authorities on this aspect. We find that though the expression used in Sec.56(2)(viib) of the Act is *“where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration”*, those words are followed by the words *“for issue of shares”*. The relevant point of time at which consideration received as *“share application money pending allotment”* becomes *“consideration for issue of shares”*, when shares are allotted/issued to the share applicant. It is only on such act of allotment that the consideration received as share application money becomes consideration for issue of shares. Admittedly, shares were issued in the previous year relevant to AY 2013-14 and therefore the provisions of Sec.56(2)(viib) stood attracted in the present case. The above conclusion is also fortified by the definition of “fair market value” for the purpose of Sec.56(2)(viib) given in Explanation (a)(ii) to Sec.56(2)(viib) which provides that the fair market value of the shares shall be the value 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. We, therefore, uphold the order of the revenue authorities on this aspect of applicability of Sec.56(2)(viib) to AY 2013-14 in the facts and circumstances of the case. We may also add that the law is well settled that in the matter of determination of total income, the law as it exists on the 1st day of the previous year is applicable and therefore the provisions of Sec.56(2)(viib) of the Act applies to AY 2013-14.

6. The next plea of the Assessee was that the valuation of shares at a premium was based on a valuation report of one Shri T. Ramachandran, Chartered Accountant, who happened to be the Authorized representative of the Assessee in the assessment proceedings. The AO was of the view that the valuation report was not independent as it was given by the CA who also acted as authorized representative of the Assessee in the proceedings before the AO. Besides the above, the AO also noticed that the CA in valuing the shares had adopted Discounted Cash Flow (DCF) method. According to the Assessee the DCF method was a permitted method of valuation in terms of Rule 11UA(2)(b) of the Income Tax Rules, 1962 (Rules) read with Sec.56(2)(viib) of the Act. The Assessing Officer did not accept the explanations of the Assessee and he was of the view that the projection made in the working as per the DCF method was provided by the Assessee company and not based on any independent analysis. The projection was irrational and did not have any relevance to the factual financial results of the assessee. The AO held that the basis of working of the value of shares under the DCF method was details and workings provided by the Assessee as per the whims and fancy of the management to arrive at higher value to issue shares at a huge premium. For these reasons, the AO rejected the valuation report prepared as per DCF method and proceeded to value shares as per the book value method and

ultimately held that a sum of Rs.86,09,018 was consideration received in excess of FMV of shares and brought the said sum to tax u/s.56(2)(viib) of the Act.

7. On appeal by the Assessee, the first appellate authority viz., the Id.CIT(A) held that the Assessing Officer is well within his powers to disturb the valuation of the chartered accountant furnished by the Assessee substantiating the fair market value. The Id. CIT(A) also relied on the decision of ITAT, Delhi in the case of *Agro Portfolio (P) Ltd Vs Income Tax Officer, Ward-1(4), New Delhi (2018) 94 Taxmann.com 112 (Delhi-Trib)*, wherein it was held as follows:-

“15. In these circumstances, we are unable to accept the contentions of the assessee that in view of the provisions under section 56(2)(viib) of the Act read with Rule 11UA(2) of the Rules the Ld. AO had no jurisdiction to adopt a different method than the one adopted by the assessee, and if for any reason the AO has any doubt recording such valuation report and does not agree with the same is bound to make a reference to the Income tax Department Valuation Officer to determine the fair market value of such capital asset. This is so because unless and until the assessee produces the evidences to substantiate the basis of projections in cash flow and provides reasonable connectivity between those projections in cash flow with the reality evidences by the material, it is not possible even for the Departmental Valuation Officer to conduct any exercise of verification of the acceptability of the value determine by the merchant banker. This is more particularly in view of the long disclaimer appended by the merchant banker at page no. 16 & 17 of the paper book which clearly establishes that no independent enquiry is caused by merchant banker to verify the truth or otherwise the figures furnished by the assessee at least on test basis. The merchant bankers solely relied upon an assumed without independent verification, the truthfulness accuracy and completeness of the information and the financial data provided by the company. A perusal of this long disclaimer clearly shows that the merchant banker did not do anything reflecting their expertise, except mere

applying the formula to the data provided by the assessee. We, therefore, are unable to brush aside the contention of the Revenue that the possibility of tailoring the data by applying the reverse engineering to the pre determined conclusions.

16. For all these reasons, we are of the considered opinion that there has not been any possibility of verifying the correctness or otherwise of the data supplied by the assessee to the merchant banker, in the absence of which the correctness of the result of DCF method cannot be verified. This left no option to the AO but to reject the DCF method and to go by NAV method to determine the FMV of the shares. Without such evidence, it serves no purpose even if the matter is referred to the Department's Valuation Officer. We, therefore, do not find any illegality or irregularity in the approach of conclusions are by the authorities below. While confirming the same, we dismissed the appeal as devoid of merits.”

8. Aggrieved by the order of the CIT(A), the Assessee is in appeal before the Tribunal.

9. With regard to the correctness of DCF method adopted by the Assessee for valuing shares and the procedure to be followed when such method of valuation is not accepted by the AO the Id. counsel for the Assessee has drawn our attention of the ITAT, Bangalore Bench in the case of *VBHC Value Homes Pvt. Ltd., Vs ITO in ITA No.2541/Bang/2019 order dated 12-06-2020*, the Tribunal after relying on the decision of the Hon'ble Bombay High Court in the case of *Vodafone M-Pesa Ltd Vs Pr.CIT 164 DTR 257* and decision of the ITAT, Bangalore Bench in the case of *Innoviti Payment Solutions Pvt. Ltd., Vs ITO(2019) 102 Taxmann.com 59* held as follows:-

“9. We have considered the rival submissions. First of all, we reproduce paras 11 to 14 from the Tribunal order cited by learned AR of the assessee having been rendered in the case of *Innoviti Payment Solutions Pvt. Ltd., Vs. ITO (supra)*. These paras are as follows:

"11. As per various tribunal orders cited by the learned AR of the assessee, it was held that as per Rule 11UA (2), the assessee can opt for DCF method and if the assessee has so opted for DCF method, the AO cannot discard the same and adopt other method i.e. NAV method of valuing shares. In the case of M/s. Rameshwaram Strong Glass (P) Ltd. vs. The ITO (Supra), the tribunal has reproduced relevant portion of another tribunal order rendered in the case of ITO vs. M/s Universal Polypack (India) Pvt. Ltd. in ITA No. 609/JP/2017 dated 31.01.2018. In this case, the tribunal held that if the assessee has opted for DCF method, the AO cannot challenge the same but the AO is well within his rights to examine the methodology adopted by the assessee and/or underlying assumptions and if he is not satisfied, he can challenge the same and suggest necessary modifications/alterations provided ITA No. 2541/Bang/2019 ITA No. 37/Bang/2020 S. P. Nos. 29 and 59/Bang/2020 the same are based on sound reasoning and rationale basis. In the same tribunal order, a judgment of Hon'ble Bombay High Court is also taken note of having been rendered in the case of Vodafone M-Pesa Ltd. vs. PCIT as reported in 164 DTR 257. The tribunal has reproduced part of Para 9 of this judgment but we reproduce herein below full Para 9 of this judgment.

"9. We note that, the Commissioner of Income-Tax in the impugned order dated 23rd February, 2018 does not deal with the primary grievance of the petitioner. This, even after he concedes with the method of valuation namely, NAV Method or the DCF Method to determine the fair market value of shares has to be done/adopted at the Assessee's option. Nevertheless, he does not deal with the change in the method of valuation by the Assessing Officer which has resulted in the demand. There is certainly no immunity from scrutiny of the valuation report submitted by the Assessee. Therefore, the Assessing Officer is undoubtedly entitled to scrutinise the valuation report and determine a fresh valuation either by himself or by calling for a final determination from an independent valuer to confront the petitioner. However, the basis has to be the DCF Method and it is not open to him to change

the method of valuation which has been opted for by the Assessee. If Mr. Mohanty is correct in his submission that a part of demand arising out of the assessment order dated 21st December, 2017 would on adoption of DCF Method will be sustained in part, the same is without working out the figures. This was an exercise which ought to have been done by the Assessing Officer and that has not been done by him. In fact, he has completely disregarded the DCF Method for arriving at the fair market value. Therefore, the demand in the facts need to be stayed."

12. As per above Para of this judgment of Hon'ble Bombay High Court, it was held that the AO can scrutinize the valuation report and he can determine a fresh valuation either by himself or by calling a final determination from an independent valuer to confront the assessee. But the basis has to be DCF method and he cannot change the method of valuation which has been opted by the assessee. Hence, in our considered opinion, in the present case, when the guidance of Hon'ble Bombay high Court is available, we should follow this judgment of Hon'ble Bombay High Court in preference to various tribunal orders cited by both sides and therefore, we are not required to examine and consider these tribunal orders. Respectfully following this judgment of Hon'ble Bombay High Court, we set aside the order of CIT (A) and restore the matter to AO for a fresh decision in the light of this judgment of Hon'ble Bombay High Court. The AO should scrutinize the valuation report and he should determine a fresh valuation either by himself or by calling a final determination from an independent valuer and confront the same to the assessee. But the basis has to be DCF method and he cannot ITA No. 2541/Bang/2019 ITA No. 37/Bang/2020 S. P. Nos. 29 and 59/Bang/2020 change the method of valuation which has been opted by the assessee. In our considered opinion and as per report of research committee of (ICAI) as reproduced above, most critical input of DCF model is the Cash Flow Projections. Hence, the assessee should be asked to establish that such projections by the assessee based on which, the valuation report is prepared by the Chartered accountant is estimated with reasonable certainty by showing that this

is a reliable estimate achievable with reasonable certainty on the basis of facts available on the date of valuation and actual result of future cannot be a basis of saying that the estimates of the management are not reasonable and reliable.

13. Before parting, we want to observe that in the present case, past data are available and hence, the same can be used to make a reliable future estimate but in case of a start up where no past data is available, this view of us that the projection should be on the basis of reliable future estimate should not be insisted upon because in those cases, the projections may be on the basis of expectations and in such cases, it should be shown that such expectations are reasonable after considering various macro and micro economic factors affecting the business.

14. In nutshell, our conclusions are as under:-

(1) The AO can scrutinize the valuation report and if the AO is not satisfied with the explanation of the assessee, he has to record the reasons and basis for not accepting the valuation report submitted by the assessee and only thereafter, he can go for own valuation or to obtain the fresh valuation report from an independent valuer and confront the same to the assessee. But the basis has to be DCF method and he cannot change the method of valuation which has been opted by the assessee.

(2) For scrutinizing the valuation report, the facts and data available on the date of valuation only has to be considered and actual result of future cannot be a basis to decide about reliability of the projections.

(3) The primary onus to prove the correctness of the valuation Report is on the assessee as he has special knowledge and he is privy to the facts of the company and only he has opted for this method. Hence, he has to satisfy about the correctness of the projections, Discounting factor and Terminal value etc. with the help of Empirical data or industry norm if any and/or Scientific Data, Scientific Method, scientific study and applicable Guidelines regarding DCF Method of Valuation."

10. From the paras reproduced above, it is seen that in this case, the Tribunal has followed the judgment of Hon'ble Bombay High Court rendered in the case of Vodafone M-Pesa Ltd., Vs. Pr. CIT (supra). The Tribunal has noted that as per the judgment of Hon'ble Bombay High Court, it was held that AO can scrutinize the valuation report and he can determine a fresh valuation either by himself or by calling a determination from an independent valuer to confront the assessee but the basis has to be DCF method and he cannot change the method of valuation which has been opted by the assessee. The Tribunal has followed the judgment of Hon'ble Bombay High Court and disregarded various other Tribunal orders against the assessee which were available at that point of time. In the present case also, we prefer to follow the judgment of Hon'ble Bombay High Court rendered in the case of Vodafone M-Pesa Ltd., Vs. Pr. CIT (supra) in preference to the judgment of the Hon'ble Kerala High Court cited by DR of the Revenue rendered in the case of Sunrise Academy of Medical Specialities (India) (P.) Ltd. Vs. ITO (supra) because this is settled position of law by now that if two views are possible then the view favourable to the assessee should be adopted and with regard to various Tribunal orders cited by learned DR of the Revenue which are against the assessee we hold that because we are following a judgment of Hon'ble Bombay High Court rendered in the case of Vodafone M-Pesa Ltd., Vs. Pr. CIT (supra), these tribunal orders are not relevant. In the case of Innoviti Payment Solutions Pvt. Ltd., Vs. ITO (supra), this judgment of Hon'ble Bombay High Court was followed and the matter was restored back to the file of AO for a fresh decision with a direction that AO should follow DCF method only and he cannot change the method opted by the assessee as has been held by the Hon'ble Bombay High Court. The relevant paras of this Tribunal order are already reproduced above which contain the directions given by the Tribunal to the AO in that case. In the present case also, we decide this issue on similar line and restore the matter back to the file of AO for a fresh decision with similar directions. Accordingly, ground No.3 of the assessee's appeal is allowed for statistical purposes.”

10. The gist of the conclusion is that the law contemplates invoking provisions of section 56(2)(viib) of the Act only in situations where the

shares are issued at a premium and at a value higher than the fair market value. The fair market value contemplated in the provisions above 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) any other value to the satisfaction of the Assessing Officer.....”

11. The law provides that, the fair market value may be determined with such method as may be prescribed or the fair market value can be determined to the satisfaction of the Assessing Officer. The provision provides an Assessee two choices of adopting either NAV method or DCF method. If the Assessee determines the fair market value in a method as prescribed the Assessing Officer does not have a choice to dispute the justification. The methods of valuation are prescribed in Rule 11UA(2) of the Rules. The provisions of Rule 11UA(2)(b) of the Rules provides that, the Assessee can adopt the fair market value as per the above two methods i.e., either DCF method or fair market value of the unquoted equity shares determined by a merchant banker. The choice of method is that of the Assessee. The Tribunal has followed the judgment of Hon'ble Bombay High Court rendered in the case of Vodafone M-Pesa Ltd., Vs. Pr. CIT (supra) and has taken the view that the AO can scrutinize the valuation report and he can determine a fresh valuation either by himself or by calling a determination from an independent valuer to confront the Assessee but the basis has to be DCF method and he cannot change the method of valuation which has been opted by the Assessee. The decision of ITAT, Delhi in the case of *Agro Portfolio Ltd. 171 ITD 74* has also been considered by the ITAT, Bangalore in the case of *VBHC Value Homes Pvt. Ltd.(supra)*.

12. In view of the above legal position, we are of view that the issue with regard to valuation has to be decided afresh by the AO on the lines indicated in the decision of ITAT, Bangalore in the case of *VBHC Value Homes Pvt. Ltd., Vs ITO (supra)* i.e., (i) the AO can scrutinize the valuation report and he can determine a fresh valuation either by himself or by calling a determination from an independent valuer to confront the assessee but the basis has to be DCF method and he cannot change the method of valuation which has been opted by the assessee. (ii) For scrutinizing the valuation report, the facts and data available on the date of valuation only has to be considered and actual result of future cannot be a basis to decide about reliability of the projections. The primary onus to prove the correctness of the valuation Report is on the assessee as he has special knowledge and he is privy to the facts of the company and only he has opted for this method. Hence, he has to satisfy about the correctness of the projections, Discounting factor and Terminal value etc. with the help of Empirical data or industry norm if any and/or Scientific Data, Scientific Method, scientific study and applicable Guidelines regarding DCF Method of Valuation. The order of Id.CIT(A) is accordingly set aside and this issue is remanded to the AO for decision afresh, after due opportunity of hearing to the Assessee.

13. In the result, the appeal is allowed for statistical purposes.

Pronounced in the open court on this 28<sup>th</sup> day of September, 2020.

Sd/-

( B R BASKARAN )  
ACCOUNTANT MEMBER

Sd/-

( N V VASUDEVAN )  
VICE PRESIDENT

Bangalore,  
Dated, the 28<sup>th</sup> September, 2020.

/Desai S Murthy/

Copy to:

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

By order

Assistant Registrar  
ITAT, Bangalore.