

**आयकर अपीलीय अधिकरण, चण्डीगढ़ न्यायपीठ “ए” चण्डीगढ़
IN THE INCOME TAX APPELLATE TRIBUNAL, CHANDIGARH
BENCH “A” CHANDIGARH**

**श्री संजय गर्ग, न्यायिक सदस्य एवं श्रीमती अन्नपूर्णा गुप्ता, लेखा सदस्य
BEFORE: SH. SANJAY GARG, JUDICIAL MEMBER &
SMT. ANNAPURNA GUPTA, ACCOUNTANT MEMBER**

आयकर अपील सं./ ITA No. 1379/CHD/2018
निर्धारण वर्ष / Assessment Year : 2015-16

The ITO, Ward 5(3), Chandigarh.	बनाम	M/s Fred Enterprises Pvt. Ltd., SCO 3688, Sector 46-C, Chandigarh.
स्थायी लेखा सं./PAN NO: AAACF5918R		
अपीलार्थी/Appellant		प्रत्यर्थी/Respondent

राजस्व की ओर से/ Revenue by : Shri Rohit Jain, Advocate
निर्धारिती की ओर से/Assessee by : Smt. C. Chandrakanta, CIT(DR)

सुनवाई की तारीख/Date of Hearing : 05/03/2020
उद्घोषणा की तारीख/Date of Pronouncement : 30/06/2020

आदेश/Order

PER ANNAPURNA GUPTA, ACCOUNTANT MEMBER:

This appeal has been filed by the Revenue against the order passed by the Commissioner of Income Tax (Appeals)-2 Chandigarh [hereinafter referred to as CIT(A)] u/s 250(6) of the Income Tax Act, 1961 (hereinafter referred to as 'Act') dated 29.08.2018, pertaining to Assessment Year(A.Y) 2015-16.

2. The solitary issue in the present appeal relates to addition made of share premium received by the assessee amounting to Rs. 13,90,45,530/-, u/s 56(2)(viib) of the Act,

on account of the same being excess consideration received over and above the Fair Market Value of shares issued,

3. Brief facts relating to the case are that during the impugned A.Y i.e, 2015 -16, the assessee company had allotted 2,35,667 equity shares of face value of Rs 100 each at a premium of Rs 590/- per share. During assessment proceedings the Assessing Officer (AO) asked the assessee to provide the valuation of the shares as per the book value and fair market value as on 31.03.2014 and provide the justification for charging the exorbitant share premium in terms of section 56(2)(viib). The assessee contented that the share application money had not been received in the relevant previous year and therefore the provisions of section 56(2)(viib) were not applicable to the case of the assessee. The AO was of the opinion that as per the Company's Act, any amount received and held pursuant to an offer made in accordance with the provisions of the Act, towards any subscription to any security including share application money or advance towards allocation of securities pending allotment, so long as such amount is appropriated only against the amount due on allotment of securities applied for shall be in nature of a Deposit. The AO noted that it is only in the financial year relevant to the assessment year under

reference that the issue of shares had taken place and hence, the cause of action had arisen in the relevant period under consideration. The AO stated that the explanation to section 56(2) (vii b) also mandated that the fair market value of shares shall be the value on the date of issue of shares. Accordingly, the contention of the assessee was rejected and the fair market value, in accordance with Rule 11(U)(b) of the Income Tax Rules, 1962, was worked out to Rs 7.92 per share and the assessee was required to show cause why the share premium of Rs 13,90,95,530/-, representing excess consideration of the issue price of the shares above the fair market value of the shares, be not treated as the income of the assessee from other sources by invoking the provisions of section 56(2)(viib). The assessee furnished detailed reply in response to the show cause notice. but the same was rejected by the AO. The AO rejected the valuation done by the assessee giving detailed reasoning in paras 5 of his order while doing so and held that the provisions of section 56(2)(viib) were clearly applicable to the assessee's case. Valuation was done in accordance with Rule 11(U)(b) of the IT Rules and the share premium of Rs 13,90,45,530/- representing excess consideration of the issue price of the shares above the fair market value of the share was added as

income from other sources to the returned income of the assessee.

4. The matter was carried in appeal before the ld. CIT(A) where detailed submissions were made by the assessee challenging the addition made on the ground that the Section 56(2)(viib) was invoked on the receipt of consideration against issue of shares and since the assessee had not received amounts in the impugned year but in the earlier years, no addition could be made under the relevant Section. Reference was made both to the provisions of the Section as well as to the rules for computing the excess share premium received as prescribed under the Income Tax Rules, 1962 i.e. Rule 11(U)(a) to the effect that both Section and the Rule when read together, it was evident that the receipt of share capital was the trigger for invoking the provisions of Section 56(2)(viib). The ld. CIT(A), after considering the submissions of the assessee and the assessment order passed, agreed with the contentions of the assessee that the Section was invoked in the year of receipt of consideration and since in the present case, no consideration was received in the impugned year, the addition made by the AO was held not sustainable under law. He, accordingly, directed deletion of the addition made. The

relevant finding of the ld. CIT(A) at para 7.3 of his order is as under :

7.3 I have considered the submissions of the appellant and perused the assessment order. The main contention in this case is whether the provisions of section 56(2)(viib) are applicable in the impugned assessment year or not.

Section 56(2) (viib) of the Act, inserted in the statute by the Finance Act, 2012 w.e.f. 01.04.2013, provides that if a company in which public is not substantially interested, issues shares at premium to any person being a resident, the excess of the aggregate consideration received for such shares over the fair market value thereof would be taxable as "income from other sources ".

The aforesaid clause (viib) to section 56(2) of the Act is reproduced hereunder for ready reference:

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.*

.....

56(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 :-*

.....

(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 1 to clause (2 3 FB) of section 10;" (emphasis supplied)

Perusal of the above section clearly shows that the following conditions are required to be fulfilled for the application of the provisions of section 56(2)(viib) of the Act:

- a) the company should receive in any previous year;*
- b) any consideration which exceeds fair market value of shares;*
- c) against fresh issue of shares.*

Thus one of the primary prerequisites for invoking provisions of section 56(2)(viib) of the Act is that the consideration against issuance of shares should be received in the previous year in which the section is sought to be invoked. It is undisputed that during the relevant previous year the assessee had only issue/allotted 235667 equity shares of Rs 10 at a premium of Rs. 590/- per share against the share application money received in financial year 2007-08, 2008-09, 2009-10 and 2010-11. Thus, in this case, the consideration was received in earlier years and no consideration has been received in the relevant previous year. In the years in which the consideration was received by the assessee, the provisions of section 56(2)(viib) were not applicable. The AO has noted in the assessment order that that as per the Company's Act, any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards any subscription to any security including share application money or advance towards allocation of securities pending allotment, so long as such amount is appropriated only against the amount due on allotment of securities applied for shall be in nature of a Deposit. It is only in the financial year relevant to the assessment year under reference that the issue of shares had taken place. Hence, the cause of action had arisen in the relevant period under consideration. I am unable to concede to this reasoning of the AO. Even if the share application money received by the assessee in the earlier previous years is considered as a deposit as per the provisions of the Company Act, the same will not alter the situation in any manner that the

consideration was "received" in those years. Moreover, neither the provisions of the Act nor the Companies Act, 2013 lay down any restrictions on the company qua the price at which fresh shares may be issued. In other words, a company is free to price the fresh issue of shares at any value. Further, share premium, by its very nature, is a capital receipt and is not income in its ordinary sense and is therefore, not eligible to tax. It is only after the amendment made in section 56(2) of the Act, effective from assessment year 2013-14 onwards, that share premium is made taxable in the hands of the company issuing shares, subject to conditions specified therein. Therefore, if the conditions specified in clause (viib) to section 56(2) of the Act are not breached, the deeming fiction of the said section would not apply and the excess share premium could not be taxed in the hands of the issuing company. The fact remains that the consideration was received in the earlier years in which the provision of section 56(2) (viib) were not applicable and no consideration was received in the previous year 2014-15 relevant for AY 2015-16 during which the provisions of section 56(2)(viib) were applicable. Thus the addition made by the AO is deleted. Since the addition has been deleted on the ground that the provisions of section 56(2)(viib) were not applicable to the allotment of shares by the assessee in the relevant previous year, the issue of valuation of these share as per Rule 11(U) (b) is not being adjudicated upon. The ground of appeal no 2 is allowed."

5. Aggrieved by the same, the Revenue has come up in appeal before us raising the following grounds :

(i) Whether in the facts and circumstances of the case and in law, the Ld.CIT(A)'s order is not perverse having erred in allowing the appeal of the assessee without appreciating the facts of the case ?

(ii) Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) was right in holding that the addition under section 56(2)(viib) can be made only if the share premium is received during the year, whereas the section 56(2)(viib) only refers to issuance of shares stating "if a company in which public is not substantially interested, issues shares at premium to any person being a resident".

(iii) Whether on the facts and circumstances of the case, the Ld. CIT(A) has not erred in law and fact in deleting the addition made on account of excess premium received on issuance of shares without appreciating the fact that shares have been issued at excessive premium in terms of section 56(2)(viib) of the Act read with Rule 11UA during the F.Y. 2014-15 and cause of action has arisen in this financial year and not in year of receipt of share application money.

(iv) Whether on the facts and in the circumstances of the case, the Ld CIT(A) has not erred in law and fact in holding that cause of action had arisen in year of receipt of share application money when as per Company's Act any amount received and held pursuant to an offer made towards any subscription to any security including share application money or advance towards allocation of securities pending allotment is in the nature of a deposit and issue of shares was in this FY.

(v) Whether in the facts and circumstances of the case and in law, the Ld.CIT(A) was right in holding that consideration was received in the earlier years in which the provisions of section 56(2)(viib) were not applicable, when the provision of Section 56(2)(viib) speaks explicitly only of Issue of Shares and provides the method for determining share premium as prescribed under Rule 11UA and does refer to share application money which was received in earlier years.

(vi) Whether in the facts and circumstances of the case and in law, the Ld.CYT(A) has violated the basic principle of interpretation of Statutes which requires that the language of the statute be given its plain and unambiguous meaning-Absoluta nstantia expositore non indigent - plain words need no exposition and when section refers to issue of shares it cannot be interpreted to refer to receipt of share application money.

(vii) It is prayed that the order of Ld. CIT(A) be set aside and that of the Assessing officer may be restored.

(viii) The appellant craves leave to add or amend any grounds of appeal before the appeal is heard or is disposed off.

6. Before us, the Revenue has challenged the order of the ld. CIT(A) contending that a plain reading of the Section alongwith the Rules reveals that the trigger for the applicability of Section 56(2)(viib) of the Act is the point of time of issue of shares and not the receipt of consideration for the same. The ld. DR pointed out that the Section prescribes that on the date of issue of shares, the Fair Market Value of the shares is to be determined and compared with the actual premium received and if the premium is in

excess of the Fair Market Value, then the addition is to be made under the Section. He further drew our attention to the rules prescribed under the Income Tax Rules, 1962 for the determination of the Fair Market Value of the shares under the Section i.e. Rule 11(U)(a) on the valuation date i.e. the date of issue of shares. He further contended that if the contention of the assessee that the Section is triggered on the receipt of consideration for issue of shares, is accepted, it would lead to absurd results. The ld. counsel pointed out that in such circumstances for the applicability of the Section, the issue of shares and the receipt of consideration both would have to take place in the same previous year. He pointed out that if the share application money is received in one year but the shares are not issued in that year, no addition can be made since the Fair Market Value cannot be determined and the Fair Market Value is the basis of comparison. He further contended that if the share application money is received in several previous years, then the question arises as to in which year the addition is to be made. He contended that the only reasonable interpretation, therefore, is that the Section is triggered on the issue of shares and not on the receipt of consideration for the same. He further contended that even as per the Companies Act, any amount received as share application money pending

allotment is not in the nature of consideration for the issue of shares but is treated as a deposit and it is only on the actual allotment of shares that the said amount changes its character and is treated as consideration for the issue of shares. The ld. DR in support of his contention, relied on the following decisions :

(i) India Today Online Pvt. Ltd. ITA No 6453 /5454/De/2018

(ii) M/s Cimex Land and Housing Pvt. Ltd. ITA No 5933/Del/2018

7. A brief synopsis of the arguments made by the ld. DR were filed before us which are reproduced hereunder :

1. The main issue is with regard to the applicability of section 56(2)(viib) given the fact that the share premium was not received in the year under consideration i.e F.Y 2014-15 but instead the share application money was received in F.Y 2007-08, 2008-09, 2009-10 and 2010-11.

2. It is the stand of the department that the trigger for the operation of the section is not the receipt of the share application money but infact the date of issue of shares. The section prescribes that on the date of the issue of the shares the fair market value of the shares is to be determined and then the value is to be compared with the share premium received and if the share premium is in excess of the fmv, then addition is to be made under the section.

3. Explanation to section 56(2)(viib) clarifies how the fair market value is to be computed either on the bases of Rule 11U or based on the value of the assets of the company on the date of the issue of the shares, whichever is higher. Rule 11U defines balance sheet as that drawn up on the valuation date. Rule 11 UA prescribes the mode of determining fmv with reference to the valuation date. Necessarily this points to the fact that the fmv that is the point of reference is the one calculated on the valuation date i.e. the date of the issue of the shares. Hence the applicability of the section hinges on the date of the issue of shares regardless of when the share application money was received.

4. The assessee's argument that since the share application money was not received in the year under consideration, and because it was received prior to the coming into effect of section 56(2)(viib) hence, the

provision of section cannot have retrospective application is based on a complete misunderstanding of the provision, for the following reasons.

(i) Since the crucial trigger is the issue of shares which took place after the section was introduced, the question of retrospective operation of the section does not arise.

(ii) According to the assessee, the point of reference is the receipt of the share application money. If we take this logic to its ultimate conclusion, this would mean that the section can be operative in only those cases where the share application money is received in the relevant previous year AND the issue of shares is also in the same previous year (determination of fmv). If share application money is received in a year but the shares are not issued in that year then, according to the assessee, no addition can be made as fmv has not been determined and calculation of fmv we know is the basis of comparison. Obviously it cannot be the intention of the legislature to make the section so limited in its operation to render it practically redundant.

(iii) Furthermore, what would happen if the share application money is received in several previous years as in the present case? Since according to the assessee it is the receipt in the relevant previous year which is the basis of addition, then in which year can the addition be made, if at all? On the contrary it would only be reasonable to say that since in those assessment years when the share application money was received the shares were not allotted, therefore the share premiums could not have been examined by the Assessing Officer u/s 56(2)(viib) of the Act.

5. According to the companies Act, any amount received as share application money pending allotment is in the nature of a deposit. It is only on the actual issue of shares that the situation changes and hence the cause of action is the actual issue of shares. (This is discussed at page 3 of the Assessment order)

Ld. Counsel for the Assessee on the hand made several arguments in support of its contention that the critical word for invoking the section was “receipt” of consideration for issue of shares and the section accordingly was to be invoked in the year when amounts were received against the

shares. Briefly put the line of arguments of the Ld. Counsel for the assessee in this regard was as under:

- a- *That the section was specifically inserted to tax receipts which otherwise were capital in nature and therefore if the conditions therein were not breached, the section would not apply.*
- b- *That as per the reading of section 56(2)(viib) the primary pre requisite for invoking the section was "receipt" of consideration against issue of shares in the previous year in which the section is sought to be invoked.*
- c- *That even as per the Rules specified for determining the Fair Market Value(FMV) of shares issued for determining the excess receipt on issue of shares, i.e; Rule 11U & 11UA of the Rules, the valuation date for valuing the shares has been stated to be the date on which the consideration "is received".*
- d- *That accordingly since the assessee had received amount against the shares in preceding years and nothing had been received in the impugned years the section could not be invoked in the impugned assessment year.*
- e- *That having regard to the facts that the share application money was received in preceding years when the provisions of section 56(2)(viib) was not even on the statute,the application of the said section in the year under consideration was clearly impermissible in law. That the use of the expression "in any previous year" followed by the expression "of consideration" refers to the year in which the consideration is received by the company and cannot be taken to mean any previous year other than the year of the receipt of the consideration.*
- f- *That the word receipt means to be given or presented with or paid something and refers to the first occasion when the recipient gets the money under his own control. Reliance was placed on the decision of the Hon'ble Apex Court in the case of Keshav Mills Ltd. Vs. CIT [1953] 23 ITR 230 in this regard.*

Ld. Counsel for the assessee further relied on the following decisions of the ITAT in support of the its contention that the provisions of section 56(2)(viib) of the Act invoked only in the year of receipt of consideration.

i. M/s Luxmi Foodgrains Pvt. Ltd. Vs. ITO in ITA No. 316/Chd/2019 order dt. 07/11/2019 (Chd Trib)

ii. ACIT vs. M/s Diach Chemicals & Pigments Pvt. Ltd in ITA No. 546/Kol/2017 order dt. 19/06/2019 (Kol Trib)

g) That any other interpretation would lead to absurd result in as much as it would be a scenario more evil than a retrospective application of section. Since in case of retrospectively, application of section inserted subsequently is applied to a transaction effected in earlier years. However in the present case the transaction took place in an earlier year and the law enacted subsequently is sought to be applied that too in later years to an earlier transaction. That the same was patently erroneous and contrary to all canons of interpretation.

8. We have heard both the parties, carefully gone through the orders of the authorities below as well as the documents and case laws referred to before us.

The issue before us relates to the interpretation of the provisions of Section 56(2)(viib) of the Act which treats as income the amount of excess consideration received on issue of shares, in excess of the Fair Market Value of shares. The controversy is relating to the point of time of trigger of the Section, whether on the receipt of amounts relating to the shares prior to being issued, i.e on receipt of share

application money or on the issue of shares, in the backdrop of the facts of the case that the assessee had received share application money in preceding years i.e A.Y 2007-08 to A.Y 2010-11 against which it allotted 2,35,667 shares in the impugned year of face value Rs.10 at premium of Rs.590/- .Admittedly the amounts received in earlier years had been reflected as share application money pending allotment and when shares were allotted/issued against them in the impugned year the said amounts were treated as share capital and the premium thereon, in excess of its face value, recognized . While the Ld. Counsel for the assessee has interpreted the provisions of the section to be stating that the section is invoked on the receipt of amounts relating to the shares, which in the present case is the preceding years ,the Revenue has offered a contrary interpretation that the section is invoked on issue of shares. Both the parties have also referred to the Rules providing the mechanism for determining the Fair Market Value of the shares, i.e Rule 11U and 11UA of the Income Tax Rules,1962 (hereinafter referred to as" Rules"),to strengthen their arguments.

To adjudicate the issue, therefore it is therefore relevant to reproduce Section 56(2)(viib) and Rule 11U and 11UA of the Rules , prescribed for determining the Fair Market Value of the shares

Section 56(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

(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 prescribed¹⁶; 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 ¹⁷[Explanation] to clause (23FB) of [section 10](#);

The Rules for determining the Fair Market value of shares for the purpose of the section prescribed in Rule 11U and 11UA of the Income Tax Rules, 1962 are reproduced hereunder :

Rule 11U

11U. For the purposes of this rule and rule 11UA,—

[(a) "accountant",—

(i) for the purposes of sub-rule (2) of rule 11UA, means a fellow of the Institute of Chartered Accountants of India within the meaning of the Chartered Accountants Act, 1949 (38 of 1949) who is not appointed by the company as an auditor under section 44AB of the Act or under section 224 of the Companies Act, 1956 (1 of 1956); and (ii) in any other case, shall have the same meaning as assigned to it in the Explanation below sub-section (2) of section 288 of the Act;

(b) "balance-sheet", in relation to any company, means,—

(i) for the purposes of sub-rule (2) of rule 11UA, the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company appointed under section 224 of the Companies Act, 1956 (1 of 1956) and where the balance-sheet on the valuation date is not drawn up, the balance-sheet (including the

notes annexed thereto and forming part of the accounts) drawn up as on a date immediately preceding the valuation date which has been approved and adopted in the annual general meeting of the shareholders of the company; and

(ii) in any other case, the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor appointed under section 224 of the Companies Act, 1956 (1 of 1956);]

(c) “merchant banker” means category I merchant banker registered with Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);

(d) “quoted shares or securities” in relation to share or securities means a share or security quoted on any recognized stock exchange with regularity from time to time, where the quotations of such shares or securities are based on current transaction made in the ordinary course of business;

(e) “recognized stock exchange” shall have the same meaning as assigned to it in clause (f) of section 2⁵ of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);

(f) “registered dealer” means a dealer who is registered under Central Sales Tax Act, 1956 or General Sales Tax Law for the time being in force in any State including value added tax laws;

(g) “registered valuer” shall have the same meaning as assigned to it in section 34AB of the Wealth-tax Act, 1957 (27 of 1957) read with rule 8A of Wealth-tax Rules, 1957;

(h) “securities” shall have the same meaning as assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);

(i) “unquoted shares and securities”, in relation to shares or securities, means shares and securities which is not a quoted shares or securities;

(j) “valuation date” means the date on which the property or consideration, as the case may be, is received by the assessee.]

Rule 11 UA

11UA. [(1)] For the purposes of section 56 of the Act, the fair market value of a property, other than immovable property, shall be determined in the following manner, namely,—

(a) valuation of jewellery,—

- (i) the fair market value of jewellery shall be estimated to be the price which such jewellery would fetch if sold in the open market on the valuation date;
- (ii) in case the jewellery is received by the way of purchase on the valuation date, from a registered dealer, the invoice value of the jewellery shall be the

fair market value;

- (iii) in case the jewellery is received by any other mode and the value of the jewellery exceeds rupees fifty thousand, then assessee may obtain the report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date;

(b) valuation of archaeological collections, drawings, paintings, sculptures or any work of art,—

- (i) the fair market value of archaeological collections, drawings, paintings, sculptures or any work of art (hereinafter referred as artistic work) shall be estimated to be price which it would fetch if sold in the open market on the valuation date;
- (ii) in case the artistic work is received by the way of purchase on the valuation date, from a registered dealer, the invoice value of the artistic work shall be the fair market value;
- (iii) in case the artistic work is received by any other mode and the value of the artistic work exceeds rupees fifty thousand, then assessee may obtain the report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date;

(c) valuation of shares and securities,—

(a) the fair market value of quoted shares and securities shall be determined in the following manner, namely,—

- (i) if the quoted shares and securities are received by way of transaction carried out through any recognized stock exchange, the fair market value of such shares and securities shall be the transaction value as recorded in such stock exchange;
- (ii) if such quoted shares and securities are received by way of transaction carried out other than through any recognized stock exchange, the fair market value of such shares and securities shall be,—

(a) the lowest price of such shares and securities quoted on any recognized stock exchange on the valuation date, and

(b) the lowest price of such shares and securities on any recognized stock exchange on a date immediately preceding the valuation date when such shares and securities were traded on such stock exchange, in cases where on the valuation date there is no trading in such shares and securities on any recognized stock exchange;

(b) *the fair market value of unquoted equity shares shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner, namely:—*

the fair market value of unquoted equity shares = (A+B+C+D - L) × (PV)/(PE), where,

A = book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance-sheet as reduced by,—

- (i) any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any; and
- (ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

B = the price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer;

C = fair market value of shares and securities as determined in the manner provided in this rule;

D = the value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property;

L= book value of liabilities shown in the balance sheet, but not including the following amounts, namely:—

- (i) the paid-up capital in respect of equity shares;
- (ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
- (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
- (iv) any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount of income-tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;
- (v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
- (vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PV= the paid up value of such equity shares;

PE = total amount of paid up equity share capital as shown in the balance-sheet;

- (c) the fair market value of unquoted shares and securities other than equity shares in a company which are not listed in any recognized stock exchange shall be estimated to be price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of which such valuation.

(2) Notwithstanding anything contained in sub-clause (b) of clause (c) of sub-rule (1), the fair market value of unquoted equity shares for the purposes of sub-clause (i) of clause (a) of Explanation to clause (viib) of sub-section (2) of section 56 shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner under clause (a) or clause (b), at the option of the assessee, namely:—

$$(a) \text{ the fair market value of unquoted equity shares } = \frac{(A-L)}{(PE)} \times (PV),$$

where,

A = book value of the assets in the balance-sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

L = book value of liabilities shown in the balance-sheet, but not including the following amounts, namely:—

- (i) the paid-up capital in respect of equity shares;
- (ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
- (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
- (iv) any amount representing provision for taxation, other than amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;
- (v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
- (vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PE = total amount of paid up equity share capital as shown in the balance-sheet;

PV = the paid up value of such equity shares; or

- (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.

9. A bare reading of the Section 56(2)(viib) , reveals that what is sought to be subjected to tax under it is the excess **consideration received during the year for issue of shares** (emphasis supplied by us), over and above the fair market value of shares. All the highlighted words, which have been used in the section, have to be read together and not in isolation. What is necessary therefore and primary for

invoking the section in a particular assessment year is there being receipt during the year, of/in the nature of consideration for the issue of shares.

Consideration, as is common knowledge is the price that a promisee in a contract agrees to pay to a promisor. It is the benefit that each party gets from a contractual deal. Therefore consideration arises only on entering into a contract. To understand when consideration arises in a contract involving issue of shares, it is necessary to understand the procedure for issue of shares. As is evident from the assessment order, page 12, the AO had noted that offer letters had been received from parties in preceding years, applying for shares in the assessee company of face value Rs. 10/- at premium of Rs.90/-. Confirmations of the concerned parties stating so is reproduced at page 13-15 of the assessment order. In the impugned year the assessee issued shares against these offers/application at a premium of Rs.590/- .Thus it appears that though the initial offer for subscription in shares by the investors was at a premium of Rs.90/- it was ultimately agreed at premium of Rs.590/- and shares issued in response to the offer accordingly by the assessee company. It is at this point of time, when the offer of the subscribers is accepted by the company by way of allotting shares to them, that the contract for issue of

shares is entered into, and the price promised to be paid under the contract by the investor is the consideration for issue of shares by the company. It is at this juncture, when the contract is entered, that consideration arises. Prior to it any amount paid cannot be termed as consideration. All/Any amount paid until then is only in the nature of a deposit/security alongwith the proposal for subscribing to the shares of the company. This deposit, on being adjusted against the price of the shares when issued, changes its character and becomes consideration for the issue of shares and at this point ,consideration can be said to be “received” against issue of shares.

In short, on the issue or allotment of shares by a company when consideration arises, all deposits or share application money received earlier take the colour of consideration and this conversion is to be treated as receipt of consideration on the issue of shares. It is at this point that all the conditions of section 56(2)(viib) can be said to be fulfilled so as to invoke the same. Thus the trigger for invoking section 56(2)(viib) of the Act is the issue of shares.

This is further evident from the explanation(a) to Section 56(2)(viib) , which explains the term Fair Market Value, for determining the excess consideration received over and above it, which is subjected to tax under the section. The

explanation states the FMV of the shares to be the value determined as per method prescribed(sub clause(i) or the value substantiated by the company to the satisfaction of the AO based on the value on the date of “**issue of shares**” of its assets including intangible assets, goodwill, know-how, patent, copy right, trade mark, franchise or other business or commercial rights of similar nature.

Thus as per clause (ii) of the explanation to the section, the FMV of the shares, is the value on the date of issue of shares. Therefore the section can be triggered or invoked only in the year of issue of shares .

The Rules prescribed for determining the Fair Market Value of the shares also makes sense and are workable only on applying this interpretation .The Rules prescribed are Rule 11U and 11UA ,both of which are reproduced above. Rule 11UA(2) specifically deals with the valuation of fair market value of unquoted shares for the purposes of section 56(2)(viib) of the Act, which is relevant for the present case. The said Rule speaks of the Fair Market Value of the shares as being the value determined in the manner prescribed therein on the **valuation date** (emphasis supplied by us). **Valuation date** in turn has been defined in Rule 11U (j) as the date on which the consideration is received.

11. On interpreting the term consideration received as being at the time of issue of shares as held by us above, the valuation date for determining FMV is the date of issue of shares. Thus a comparison of the fair market value of shares and the consideration received, both relating to the issue of shares is made and the surplus if any is subjected to tax. This is a reasonably sound and logical interpretation since the section, subjects to tax the excess consideration received by over pricing the value of shares issued. Overpricing or excess consideration can be determined when the actual price and the market price relating to issue of shares is compared. If the trigger for the invocation of the section is in the year of receipt of amounts relating to shares prior to their being issued, the excess consideration received above the FMV of shares cannot be determined because, since the shares have not been issued, there cannot be FMV of anything which is not even in existence.

12. We, therefore, agree with the contention of the Id. DR that the provisions of Section 56(2)(viib) are triggered in the year the shares are issued.

13. The arguments of the Ld. Counsel for the assessee are all based on laying emphasis solely on the word "received" used in the section, which hold no ground since as we have

held above the words used in the section are not to be read in isolation and the correct interpretation lies in the meaning of the phrase “consideration received on issue of shares”, which we have held relates to the year of issue of shares and not before.

As for the reliance placed by the ld. CIT(A) on the decision of the Kolkata Bench of the ITAT in the case of Diach Chemicals and Pigments(supra),we find that the same is distinguishable on facts since in the facts of the said case the shares were found to have been applied for in earlier year as per terms and conditions settled in that year and accordingly it was held that the provisions of section 56(2)(viib) were invoked in that year and not in the year of allotment of shares.In the case before us the terms and conditions of issue of shares were not settled in the year of application for shares but on the contrary in the year of allotment since while the application had been made at a premium of Rs.90/- the shares were allotted in the impugned year at a premium of Rs.590/-. The said decision therefore is of no assistance to the assessee.

The decision of the ITAT Chandigarh Bench in the case of Luxmi Foodgrains(supra) is also distinguishable on facts since in that case the dispute about the invocation of section 56(2)(viib) arose on account of the fact that the

consideration received by way of cheques had not been encashed by the assessee at all and therefore he disputed the applicability of the section on the ground of receipt of consideration .There was no dispute about consideration having arisen in that case ,which distinguishes it from the present case.

Thus, reading the provisions of the Section and the Rules prescribed for determining the Fair Market Value of shares, what is arrived is that the provisions of Section 56(2)(viib) are triggered in the year of issue/allotment of shares.

In the present case, since the shares were issued in the impugned year, the provisions of Section, we hold, have been rightly applied by the AO in the impugned year and the order of the AO to that extent is upheld.

Further since the Ld.CIT(A) allowed the assessee's appeal on this ground alone and did not therefore adjudicate the issue of determination of Fair Market Value of the shares issued, the CIT(A) is directed to adjudicate this aspect.

14. In the result, appeal of the Revenue is allowed.

Order could not be pronounced earlier due to non-functioning of the Bench on account of curfew / lockdown in the wake of Covid-19 Pandemic.

Order pronounced on 30th June,2020.

Sd/-

(संजय गर्ग)
(SANJAY GARG)

न्यायिक सदस्य/ Judicial Member
"Poonam"

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

1. अपीलार्थी/ The Appellant
2. प्रत्यर्थी/ The Respondent
3. आयकर आयुक्त/ CIT
4. आयकर आयुक्त (अपील)/ The CIT(A)
5. विभागीय प्रतिनिधि, आयकर अपीलीय आधिकरण, चण्डीगढ़/ DR, ITAT, CHANDIGARH
6. गार्ड फाईल/ Guard File

Sd/-

(अन्नपूर्णा गुप्ता)
(ANNAPURNA GUPTA)

लेखा सदस्य/ Accountant Member

आदेशानुसार/ By order,

सहायक पंजीकार/ Assistant Registrar