

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'C', NEW DELHI**

Before Sh. A. D. Jain, Vice-President

Dr. B. R. R. Kumar, Accountant Member

ITA No. 9042/Del/2019 : Asstt. Year : 2015-16

Intelligrape Software Pvt. Ltd., C/o Sanjiv Sapra & Associates LLP, CA, C-763, New Friends Colony, New Delhi-110025	Vs	DCIT, Circle-12(2), New Delhi
(APPELLANT)		(RESPONDENT)
PAN No. AABCI9247F		

Assessee by : Sh. Sanjiv Sapra, FCA

Revenue by : Sh. Umesh Takyar, Sr. DR

Date of Hearing: 28.10.2021

Date of Pronouncement: 28.01.2022

ORDER

Per Dr. B. R. R. Kumar, Accountant Member:

The present appeal has been filed by the assessee against the order of Id. CIT(A)-44, New Delhi dated 30.08.2019.

2. Following grounds have been raised by the assessee:

"1. That the Ld. CIT(A) has erred on facts and in law in confirming the addition of Rs.2,11,01,363/- under section 56(2)(vii)(b) of the Income-tax Act on account of alleged excess value of unquoted equity shares as issued by the Appellant at a premium over fair market value as determined by the AO.

2. That the valuation report for valuing unquoted equity shares of the Appellant private company as issued by the Chartered Accountant Valuer/independent expert appointed by the Appellant as per the Discounted Cash Flow ("DCF") valuation methodology opted for by it in accordance with specific Rule 11UA(2) of Income-tax Rules could not be disregarded or rejected by the AO particularly when

Explanation (a)(i) to section 56(2)(viib) does not speak of any satisfaction of the AO.

3. That without prejudice to Ground No. 2 above, the authorities below could not have rejected the valuation report of Chartered Accountant Valuer/independent expert is filed by the Appellant and hence such action of the authorities below was unjust and illegal.”

3. During the financial year relevant to the Assessment year under assessment, the assessee company was engaged in the business of IT related services.

4. During the Course of assessment proceedings, the AO is noticed that the assessee company has allotted equity shares of face value of Rs.10/- each as per chart given below to M/s Tangerine Digital Entertainment Pvt. Ltd. which is a closely held company of the assessee company:

Date of allotment	No. of shares	Face value	Security premium	Fare value as per valuation	Issue price per share	Excess price for 56(2)(viib)
01-05-2014	2262	22,620	139,77,3	6189	6,189	NA
23-02-2015	600	6,000	49,94,00	8328	8,333	NA
30-03-2015	518	5,180	43,13,47	8328	8,337	NA
Total	3380		2328484			

5. As per above chart, the assessee company has received premium on issue of shares to the tune of Rs.2,32,84,843/-. Therefore, during the course of assessment proceedings, the AR was asked to justify the premium received over and above the fair market value of the shares with documentary evidence in terms of section 56(viib) of I.T. Act.

6. Before the AO, the Id. AR has filed valuation report dated 11.12.2014 of M/s Intelligrape Software Pvt. Ltd. prepared by M/s Puneet Puri & Company wherein value of one share has been valued at Rs. 8,328/- per share.

7. Upon examination of the valuation report dated 11.12.2014 as given by the Id. AR of the assessee company during the course of assessment proceedings, it was noticed that the valuation report was prepared by the valuer on 11.12.2014 while shares were issued on 01.05.2014, 23.02.2015 and 30.03.2015. As per Rule 11UA fair market value of the equity share on the valuation date should be valued on which the shares issued but in this case more than six month difference in between the valuation date and date on which shares were actual issued. In addition to above, the assessee itself vide letter dated 19.12.2017 admitted that its PAT has been declined. The relevant portion of the said letter reproduced here under:

"Our PAT decline in FY 15-16 due to unexpected exceptional bad debts and high employee cost and hence projected PAT was not achieved. However, our projected PAT was comparably achieved after excluding unexpected bad debts and exceptional costs with actual PAT in FY 16-17.

Projected free cash flow is also comparably matching with our actual free cash flow after excluding unexpected bad debts and exceptional costs for FY 16-17. Details provided below:

<i>Particulars</i>	<i>FY 2016-17</i>
<i>Profit after tax</i>	<i>355,91,021</i>
<i>Add: Exceptional items debited</i>	<i>770,73,693</i>
<i>Add: Foreign exchange loss</i>	<i>149,61,148</i>
<i>Add: Depreciation</i>	<i>164,94,777</i>
<i>Less: capex</i>	<i>(117,20,222)</i>
<i>Less: Changes in Net working capital</i>	<i>(948,12,523)</i>
<i>Actual free cash flow</i>	<i>375,88,494</i>
<i>Projected free cash flow as per valuation certificate dated 11th Dec. 2014</i>	<i>440,00,000</i>

8. The AO held that the company has inflated the value of the shares through project report and the value of share has been hypothetically increased to Rs. 8328/- per equity share by the assessee company. A discounted cash flow (DCF) is a valuation method used to estimate the attractiveness of an investment opportunity. DCF analysis uses future free cash flow projections and discounts them to arrive at a present value estimate, which is used to evaluate the potential for investment. The excess cash is used to expand production, develop new products, make acquisitions, pay dividends and reduce debt. Specifically, FCF is calculated as: $EBIT (1 - \text{tax rate}) + (\text{depreciation}) + (\text{amortization}) - (\text{change in net working capital}) - (\text{capital expenditure})$. In finance, discounted cash flow (DCF) analysis is a method of valuing a project, company, or asset using the concepts of the time value of money. All future cash flows are estimated and discounted by using cost of capital to give their present values (PVs). The discount rate is the rate of return used in a discounted cash flow analysis to determine the present value of future cash flows and the assessee has failed to prove the basis of discounted rate used. In a discounted cash flow analysis, the sum of all future cash flows (C) over some holding period (N), is discounted back to the present using a rate of return (r) and the assessee has failed to prove the basis of future cash flows over some holding period and discounted back to the present using a rate of return. In result the valuation is not acceptable based on cash flow method.

9. Accordingly, the fair market value of Assessee Company i.e. M/s Intelligrape Software Pvt. Ltd. is calculated as per the provision of rule 11UA of I.T. Rules 1961. Calculation of value

per share under NAV method on the basis of audited figure of financial statement of FY 2014-15:

		<i>As at 31/03/2015</i>
a)	<i>Total Asset excluding Misc Expenditure & P&L Dr Balance</i>	<i>1163,23,538</i>
b)	<i>Less -Total Liability excluding contingent liability</i>	<i>488,54,805</i>
c)	<i>Net assets value (a-b)</i>	<i>694,68,733</i>
d)	<i>Less- Preference shares value</i>	<i>-</i>
e)	<i>Value of net assets attributable to Equity Share Holders (c-d)</i>	<i>694,68,733</i>
f)	<i>Number of equity shares as at 31/03/2015</i>	<i>1,05,971</i>
<i>Value of Share (e/f)</i>		<i>656</i>

10. In view of above, the AO held that the net worth of each equity share of M/s Intelligrape Software Pvt. Ltd. comes to Rs. 656/-. The premium amounting to Rs.2,11,01,363/- (Rs. 2,32,84,843- Rs.21,83,480/-) received in excess of fair value is to be added to the income of the assessee during the year under consideration.

11. The Id. CIT(A) confirmed the same holding that the valuation reports submitted do not provide for the date of valuation. Under the DCF method, the date of valuation is very important as projections of free cash flows, terminal value, discounting etc. are determined on the date of valuation. The Institute of Chartered Accountants of India in the "Technical Guidance on Shared Valuation" have pointed out that valuation is time specific and that the date of valuation is critical to the report. The Id. CIT(A) while confirming the addition made by the AO held that,

- While computing the cost of equity, through Capital Asset Pricing Model, beta coefficient i.e. unsystematic risk has been estimated at 1.23. Beta measures response to the market as a whole. No reason has been stated in the report wide the coefficient has been estimated at 1.23. Details of beta are generally available on the website of NASE, BSE etc. The basis of estimating beta has been stated to be the Chartered Accountants understanding of the risk in similar industries. However, the above statement has not been explained. A slight difference in beta coefficient can have a strong impact on the cost of equity which can influence the valuation of the shares.
- While computing the Weighted Average Cost of Capital in the valuation report, the cost of debt is considered and a debt equity ratio of 30:70 has been taken for which no basis has been provided.
- The Valuation Report has taken a growth rate of 3% for calculating the terminal value of business and no basis has been provided for the same.
- The computation of free cash flows and the assumptions underlying the same have also not been explained in the report.
- The value and has mentioned that on the financial statement and other data pertaining to the company had been provided by the management of the company and had been accepted and relied upon by the valuer without further verification including nonconformity or conformity with the generally accepted accounting principles and/or other guidelines established by the regulatory bodies. The

valuer has also stated that reported facts, comments, estimates, opinions and statistical information in the valuation exercise had been obtained from sources believed to be accurate and reliable and no liability was assumed for the content or accuracy of the data furnished by others including information and representations provided by the management.

12. We have perused the entire material on record. The similar issue in the case of the same assessee has been adjudicated by this Tribunal wherein one of the Member's is the author of the judgment for the A.Y. 2014-15 in ITA No. 3925/Del/2018 wherein the objections raised by the Id. CIT(A) have been duly deliberated. For the sake of ready reference, the relevant portion of the said order is reproduced below:

"14. We have gone through the valuation report submitted by the assessee. The same is as under:

"The Fair value is determined based, on the Discounted Free Cash Flow method of the projected financials and other details furnished by the company. Discounted Free Cash Flows (DCF) entails estimating future free cash flows of the business and discounting them using an appropriate rate of return to arrive at the net present value of the net cash flows.

The valuation has been carried out on a going concern basis presuming that the company will continue its business operation in the current financial year and will continue to do business in the foreseeable future, wherein the potential investor will evaluate the expected returns and associated risks on continuing basis.

BASIS OF VALUATION

The Fair Value is based on the following:

- a. Financials forecasts made by the management of the company for 5 years and provided to us.*
- b. Information gathered based on the discussions with the management and representatives of the company.*
- c. The assumptions which we feel are prudent to determine the ' Pre Money valuation.*

All the above information and facts have been relied on without auditing and verification.

DISCOUNTED CASH FLOWS:

The financials forecasts provided by the management form the basis for our DCF analysis and assumptions based on the perception of attendant circumstances of the case.

Value of Firm: The value of the firm is obtained by discounting expected cash flows after meeting all operating expenses and taxes but prior to any payments either debt or equity holders, at the weighted average cost of capital, which is the cost of the different components of financing used by the firm, weighted by their market value proportions.

Cost of Equity or the Discounting Factor: Discounting rate is the rate of return that a willing buyer would expect to receive from an investment to compensate the inherent risks involved and for the time value of money. The cost of equity is calculated on the basis of Capital Asset Pricing Model (CAPM).

*Cost of Equity = Risk free rate + [Beta *(Market risk premium)]*

- Risk free rate is considered as 4 percent and market risk, premium is considered to be 7.1 percent.
- Beta has been estimated at 1.23 based on our understanding of the business risk in the similar industries.

On the above basis the cost of equity is arrived as follows:

Cost of Equity = 4 Percent + (1.23 * 7.1 percent) = 12.73 percent

Further, as the privately held shares are not traded in public, the shares of these companies are not generally as liquid as those of public companies. The lack of marketability increases the cost of equity also by another 1.7 percent accordingly the Cost of Equity-becomes 14.4 percent.

Weighted Average cost of Capital - The weighted average cost of capital (WACC) is the rate that a company is expected to pay on average to all its security holders to finance its assets. The WACC is calculated taking into account the relative weights of each components of the capital structure of the Company. In the instant case of the cost of equity and cost of debt is weighted in the ratio of 70:30. Accordingly,

WACC = (70 percent X 14.4 percent) + (30 percent X 13 percent) = 13.12 percent

Terminal Value: The Terminal Value of the Company is calculated based on the perpetuity growth model assuming a growth factor of 3 percent which is considered to be appropriate in the light of past trend and growth.

Equity Value: The Free Cash Flow and the Terminal value are discounted to their present values at the valuation date by

applying the discounting rate of 13 percent as determined above. Thereafter, after netting off the cash and cash equivalents with the loan liability as on the date of the valuation. Since, we are doing Pre Money Valuation, no calculations are considered for deriving the Post Money Equity value.

Fair Value Calculation

Allocating the total Pre Money Equity Value of the company arrived using the DCF valuation method of Rs 61.74 crores among the issued equity i.e. 100000 shares, the fair value of the share is Rs.6,175.00 (Rupees Six Thousand One Hundred and Seventy Five).

Enterprise value

<i>Present value of Free cash Flow</i>	<i>164</i>
<i>Terminal Value</i>	<i>878</i>
<i>Discount Factor</i>	<i>0.51</i>
<i>Present Value of Terminal Value</i>	<i>448</i>
<i>% of Enterprise Value</i>	<i>73%</i>

<i>Enterprise Value</i>	<i>612</i>
<i>Less: Total debt</i>	<i>0</i>
<i>Plus: Cash and Cash Equity</i>	<i>5</i>
<i>Net Debt</i>	<i>-5</i>

<i>Implies Equity Value</i>	<i>6174,87,612</i>
<i>Outstanding shares</i>	<i>1,00,000</i>
<i>Implied share price</i>	<i>6,174.88</i>

Implies Multiple

<i>Enterprise Value</i>	<i>612</i>
<i>SALES 2013</i>	<i>97</i>
<i>EBITDA 2013</i>	<i>37</i>
<i>Implied EV/SALES</i>	<i>6.3x</i>
<i>Implied EV/EBITDA</i>	<i>16.6x</i>

The Annexure to this Certificate contains the basis for arriving at the Fair Value of equity shares.

LIMITATIONS

1. All financial statement and other data pertaining to the Company have been provided by the management of the company and we have accepted and relied on without further verification, including conformity or non-conformity with generally accepted accounting principles and/or other guidelines established by regulatory bodies.

2. All reported facts, comments, estimates, opinions and statistical information set forth in the valuation exercise have been obtained from sources believed to be accurate and reliable. No liability is assumed for the content or accuracy of the data furnished by others, including all information and representations provided by the management.

3. No attempt has been made to verify and audit the estimates and assumptions made by the management of the company.

4. The valuation of the company is been done solely at the request of the management and in our opinion may be considered as fair value for the purpose of fair valuation under section 56 of the Income Tax Act,1961.”

15. In this background, the rationale of the Assessing Officer and the figures adopted by the AO while making the disallowance is examined. The same are as under:

EBITDA	13-14	14-15	15-16	16-17	17-18
Actual Profit/Loss as reported in ITR/Final Accounts	Not reported	3.7 cr.	6.8 cr.	8.4 cr.	10.1cr.
		-33.54 lacs	95.94lacs	4.06 cr.	-----

16. The AO computed the EBITDA with actual profit in the ITR. The correct figures to be used for comparison are as under:

<i>Particulars</i>	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>
<i>Sales</i>	<i>13</i>	<i>28</i>	<i>59</i>	<i>92</i>
<i>Expenses (Excluding Depreciation, Interest & Tax)</i>	<i>12</i>	<i>26</i>	<i>58</i>	<i>85</i>
<i>EBITDA</i>	<i>0</i>	<i>2</i>	<i>2</i>	<i>7</i>
<i>As per Valuation Certificate</i>	<i>4</i>	<i>7</i>	<i>8</i>	<i>10</i>

17. Further, we have also gone through the statement of projected revenues and revenue earned as per the audit report. The same are as under:

"As per certificate dated 30 May, 2013 projected turnover was taken INR 97 Million for FY 2013-14 whereas company has achieved a turnover of INR 126 Million for FY 2013-14. Comparison in this regard for three years is as under:

<i>FY</i>	<i>Projected Revenue</i>	<i>Revenue as per Audited Financial Statement</i>
<i>2014-15</i>	<i>145 Million</i>	<i>285 Million</i>
<i>2015-16</i>	<i>182 Million</i>	<i>594 Million</i>
<i>2016-17</i>	<i>227 Million</i>	<i>920 Million</i>

18. From the above table, it is glaring to observe that the actual revenues are far more than the projected revenue. Hence, the valuation cannot be faulted with.

19. With regard to section 56(2)(viib) as applied by the AO for making the addition on account of alleged excess share premium, reference is made to Explanation (a)(i) of such Section which states that fair market value of the shares shall be the value "as may be determined in accordance with such method as may be prescribed'. It is not in dispute that such method is prescribed in specific Rule 11UA(2) of I.T. Rules as applicable for issue of unquoted equity shares, which states that fair market value of unquoted equity shares is to be determined as per clause (a) or clause (b) of Rule 11 UA(2) at

the option of the Assessee. Clause (a) refers to book value method whereas clause (b) refers to DCF method as supported by valuation report of a merchant banker or a chartered accountant. In the instant case, the assessee had opted for clause (b) of Rule 11UA(2) of I.T. Rules by applying DCF method and obtained valuation report from a chartered accountant thereby fulfilling both the requirements of such specific Rule.

20. When the assessee Company had opted for valuation of unquoted equity shares in accordance with DCF method as prescribed under clause (b) of specific Rule 11UA(2) as applicable, the AO/CIT(A) had no power/authority to change such valuation methodology and adopt a different book value method as prescribed under clause (a) of such Rule and hence such action of the authorities below was arbitrary.

21. It is trite law that "when a statute requires, a thing to be done in a certain manner, it shall be done in that manner alone and not otherwise" (CIT vs. SPL'S Siddhartha Ltd. 345 ITR 223).

22. Unlike Explanation (a)(ii) of section 56(2)(viib), where it has been specifically provided that valuation is to be substantiated to the satisfaction of the AO, there is no such provision specified therein in Explanation (a) (i) of section 56(2)(viib) as opted for by the assessee for substantiating its valuation to the satisfaction of the AO. Hence, on the facts of assessee's case, the AO was not empowered to disregard the DCF valuation as carried out by the valuer and such action of the authorities below of rejecting such valuation report cannot be upheld. (Rameshwaram Strong Glass P Ltd., ITAT Jaipur)

23. The AO was not able to pinpoint any specific inaccuracies or short comings in the DCF valuation report of the Chartered Accountant/Valuer other than stating that year-wise results as projected are not matching with the actual results declared in the final accounts. Before the Id. CIT(A), reasons for variation between projected and actuals were duly explained. The Id. CIT(A) has accepted such explanation but rejected the DCF valuation report as submitted by the assessee. Accordingly, in the absence of any defect in the valuation of shares arrived by the assessee on the basis of DCF method, impugned addition as made on the basis of net asset value method is liable to be deleted. The rejection is unjustified as the valuation report is required under Rule 11UA of The Income Tax rules is based on the future aspects of the company at the time of issuing the shares, it may vary from the actual figures depending on the market condition at the present point of the time.

24. Thus, keeping in view the entire facts of the case, the reports of the valuer, the comparison of the actual and projected revenues, provisions of Section 56(2)(viib) and keeping in view the order of Co-ordinate Bench of ITAT in the case of Cinestaan Entertainment Pvt. Ltd. 177 ITD 809 wherein it has been held that the Assessing Officer cannot substitute his own value in place of the value determined either on DCF method or NAV method, the appeal of the assessee is hereby allowed."

13. In the absence of any change in the material facts and legal proposition, we hereby allow the appeal of the assessee.

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

Order Pronounced in the Open Court on 28/01/2022.

Sd/-

(A. D. Jain)
Vice President

Dated: 28/01/2022

Subodh Kumar, Sr. PS

Copy forwarded to:

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

Sd/-

(Dr. B. R. R. Kumar)
Accountant Member

ASSISTANT REGISTRAR