

THE INCOME TAX APPELLATE TRIBUNAL
“F” Bench, Mumbai
Shri B.R. Baskaran (AM) & Shri Rahul Chaudhary (JM)

I.T.A. No. 3531/Mum/2019 (A.Y. 2014-15)

DCIT-1(3)(2) Room No. 540 5 th Floor Aayakar Bhavan M.K. Road Mumbai-400 020. (Appellant)	Vs.	Unique Land Realty Pvt. Ltd. Saheb Building, 4 th Floor 195, D.N. Road, Fort Mumbai-400 001. PAN : AABCU1230G (Respondent)
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Assessee by	Subodh Ratnaparkhi
Department by	Ms. Vranda U. Matkari
Date of Hearing	28.06.2022
Date of Pronouncement	15.07.2022

ORDER

Per B.R.Baskaran (AM) :-

The Revenue has filed this appeal challenging the decision rendered by learned CIT(A) in deleting the addition of Rs. 8.71 crores made by the Assessing Officer under section 68 of the Act and also alternatively under section 56(2)(viib) of the Act.

2. Facts relating to the issue are stated in brief. The assessee is engaged in real estate business. During the year under consideration the assessee has issued 348400 – 12% redeemable preference shares to M/s. Magi Fin Stock Pvt. Ltd. (MFPL) at a price of Rs. 250/- per share, which consisted of face value of Rs.10/- per share and share premium of Rs. 240/- per share. Thus the assessee collected the share capital of Rs. 34,84,000/- and share premium of Rs. 8,36,16,000/-, both aggregating to Rs. 8,71,00,000/-. The AO examined the above said receipt of money in terms of sec.68 of the Act. The assessee furnished various documents in support of receipt of above said amount. The assessee also furnished a valuation report dated 23.2.2014 given by M/s. Khusboo Jain & Associates, Chartered Accountants determining value of

proposed redeemable preference shares at Rs. 250/- per share. The Assessing Officer, thereafter, issued notice under section 133(6) of the Act to the subscriber MFPL in order to examine the nature and source of Rs. 8.71 crore received by the assessee. The above said MFPL duly replied to various queries posed by the Assessing Officer along with supporting documentary evidences including audited accounts for the year ending 31.3.2012 to 31.3.2014. However, the Assessing Officer took the view that the assessee has failed to offer satisfactory explanations with regard to nature and source of amounts received by the assessee. The main reasoning given by the Assessing Officer for rejecting explanations given by the assessee as well as by the subscriber of preference shares are summarized below :-

- a) Assessee and subscriber are engaged in different business.
- b) Assessee operates in Mumbai whereas the subscriber is small time trader carrying on business in Mandsaur, Madhya Pradesh.
- c) Subscriber has stated that the assessee is family company belonging to family friends, meaning thereby subscriber has not carried out due diligence before investing money in assessee's company.
- d) Turnover of the subscriber MFPL was less than Rs. 11 lakhs and it has also reported low profit.
- e) M/s. MFPL has passed resolution authorizing investment Rs. 8.71 crore in the assessee company on 6.6.2013. On that date, authorised redeemable preference shares of the assessee company was not even in existence.
- f) Valuation report for the preference shares was given by the Chartered Accountant on 23.2.2014 only.
- g) The date of allotment of preference shares is stated to be 19.3.2014 i.e. after expiry of nine months from the date of passing of resolution.
- h) Preference shares are redeemable after five years at a price of Rs. 441/- per share which includes issue price of Rs. 250/- plus accumulative dividend of five years. However share certificate does not indicate anything about the terms of issue of preference share.

The Assessing Officer also expressed the view that it is the responsibility of the assessee to prove the nature and source and in this regard he placed reliance on the decision rendered by Hon'ble Supreme Court in the case of CIT Vs.

Durga Prasad More (82 ITR 540) and also Sumati Dayal Vs. CIT. Accordingly the Assessing Officer assessed the amount of Rs. 8.71 crore as unexplained cash credit under section 68 of the Act.

3. The Assessing Officer, alternatively, assessed the above said amount under section 56(2)(viib) of the Act on the following reasoning:-

(a) The Chartered Accountant, who issued valuation report, has followed "Discounted free cash flow method" (DCF) for valuing the value of shares.

(b) However, provisions of rule 11UA do not prescribe DCF method for valuing preference shares. The DCF method of valuation has been prescribed for valuing 'equity shares' only.

Accordingly, the Assessing Officer took the view that the assessee has not substantiated share premium amount and accordingly held that the amount of Rs. 8.71 crores is also assessable as income of the assessee under section 56(2)(viib) of the Act.

4. The Learned CIT(A) deleted the addition both u/s 68 and sec.56(2)(viib) of the Act. Hence revenue has filed this appeal before us.

5. The Ld D.R placed her reliance on the decision rendered by Hon'ble Supreme Court in the case of NRA Iron Steel Pvt Ltd (Civil No. 29855 of 2010) and submitted that the practice of conversion of unaccounted money through the clock of share capital/premium must be subjected to careful scrutiny. She submitted that the assessee has failed to prove the receipt of preference share capital/premium to the satisfaction of the AO. Accordingly, the Ld D.R submitted that the AO has rightly assessed the amount received by the assessee u/s 68 of the Act. She further submitted that the assessee has valued the Preference shares under Discounted Free Cash flow method, which can be applied only to unquoted equity shares.

6. On the contrary, the Ld A.R strongly supported the order passed by Ld CIT(A). He submitted that the Ld CIT(A), after examination of the evidences submitted by MFPL in response to notice u/s 133(6) including answers given to the 17 specific questions put to the said MFPL as well as on examination of available evidences with regard to the issue of preference shares, has held that the assessee has adequately discharged the burden placed u/s 68 and hence the addition is not justified. He further submitted that the facts prevailing in the case of NRA Iron and Steel are different from the facts available in the instant case. He submitted that, in the case of NRA Iron & Steel, the enquiries conducted by the AO revealed that share application money was not received from independent legal entities and some of the entities were found to be non-existent. On the contrary, against the enquiries conducted by the AO in the instant case, MFPL has duly responded to him and furnished all relevant documents. Hence the decision rendered by Hon'ble Supreme Court in the case of NRA Iron & Steel cannot be applied in the instant case.

7. With regard to the addition made u/s 56(2)(viib) of the Act, the Ld A.R submitted that the Rule 11UA(1)(c) does not prescribed any specific method for valuing preference shares. He submitted that the Discounted Free cash flow method is one of the recognized methods.

8. We heard rival contentions and perused the record. We notice that the Ld CIT(A) as analysed the facts of the present issue threadbare and accordingly deleted the addition. For the sake of convenience, we extract below the observations made and the decision taken by Ld CIT(A):-

“Decision

I have carefully considered the facts of the case, AO's contentions, submissions of the appellant as well as the case laws relied upon by the appellant including the additional ground of appeal.

The assessee in the year under appeal has received Rs.8,71,00,000/- towards allotment of Rs.3,48,400/-12% redeemable preference shares to M/s Magi Fin Stock Pvt. Ltd. (MFPL) at Rs.10/- per share (face value) with the share premium of Rs.240/- per share. The details of allotment of preference shares to the said company are tabulated as under :

Sr. No.	Name of the applicant Preference share holder	No. of Preference shares issued	Face value per share (Rs.)	Premium Per share (Rs.)	Total amount received by the assessee (Rs.)
1	M/s Magi Fin Stock Pvt. Ltd. (MFPL), 69, Agrsen Nagar, Behind Mid India, Mandasaur, PIN 458002, Madhya Pradesh	348400	10/-	240/-	8,71,00,000/-
	Total	348400			8,71,00,000/-

The above amount of Rs.8,71,00,000/- is credited in the books of the assessee as under.

Share capital: 12% redeemable preference shares	Rs. 34,84,000/-
Reserves & Surplus : Securities premium account	Rs. 8,36,16,000/-
Total	Rs. 8,71,00,000/-

In the course of asst. proceedings, the assessee in response to the enquiry by the AO submitted the under mentioned evidences with regards to issue of 12% redeemable preference shares to MFPL

S.No.	Nature of documents
1	Letter submitted by assessee in the course of asst. proceedings dt. 03.11.2016, 21.11.2016 & 21.12.2016
2	Form No. 5 filed with Registrar of Companies for reclassification of unissued Authorized Share Capital
3	Notice of meeting dated 05.03.2014 alongwith Board resolution dt. 19.03.2014 for approval of the terms of issue and allotment of 12% Redeemable Preference Shares.
4	Terms of issue of the 12% redeemable preference shares.
5	Form no. PAS-3 filed with Registrar of Companies for allotment Preference Shares on 31.07.2014.
6	Copy of resolution passed at EGM of members of assessee company on 04.01.2014.
7	Valuation report dt 23.02.2014 issued by Khusboo Jain & Associates, Chartered Accountants for determining fair value of Redeemable Preference Shares.
8	Copy of Ledger account of MFPL in the books of the appellant.
9	Bank statement of the appellant with Axis Bank duly highlighting receipt of money towards share allotment.
10	Bank statement of MFPL with Corporation Bank highlighting payments to assessee.
11	ITR-V Acknowledgement for filing of IT return by MFPL for A.Y. 2014-15 alongwith audited financial statements.
12	Copy of share certificate issued to MFPL.

The AO has in the asst. order tabulated his objections to be acceptability of the said transaction at para 8/pg nos. 6 to 8 of the asst. order. The assessee has addressed these objections with the following explanations.

	Doubts raised by learned AO	Explanation of the assessee
(i)(a)	Appellant is situated in Mumbai & investor company in Mandasaur, Madhaya Pradesh with a small population of 141667.	This is hardly relevant to doubt the investment in the appellant company. Investor company is a Private Ltd Company holding a valid IT PAN/company law CIN No. with its books of accounts being audited by a Chartered Accountant.
(i)(b)	Relationship	The directors of the investor company knew about the appellant company and its real estate project and therefore the investment. This is what is explained by the investor company to the Id. AO and should not be disputed.
(i)(c)	Total sales of the investor company/net profit is low.	Again not relevant. The Id. AO in the same discussion has noted that total assets of the investor company are to be the tune of Rs. 9,66,20,893/-.
(ii)(a)	MFPL has passed board resolution on 06.06.2013 authorizing investment appellant company.	The Id. AO has not shared any information about board resolution of MFPL with the appellant in the course of asstt. proceedings and therefore the appellant is unable to comment on the issue.
(ii)(b)	Ledger a/c of MFPL in the books of the appellant does not indicate that receipt of Rs. 8,71,00,000/- is adjusted to share premium a/c.	The ledger a/c of MFPL (enclosed at pg no. 77) records the amt. received to be for 12% redeemable preference shares.
(ii)(c)	That board resolution approving valuers report was passed on 19.03.2014 whereas resolution approving issue of redeemable preference shares was passed on 18.03.2014.	This is not correct. Resolution for issue of preferences shares was also passed in 19.03.2014 only. Kindly refer to enclosed pg no. 60 & 61. Even the letter filed by the assessee on 15.12.2016 before the Id. AO (Copy at enclosed pg no. 125) also states the date to be 19.03.2014 only.
(ii)(d)	Allotment is after substantial time after decision by MFPL to invest in shares of appellant.	Not material to dispute the investment by MEPL.
(ii)(e)	The quantum of dividend is not indicated or issue of unpaid dividend discussed by Id. AO.	Clause no. 3 of Terms of issue (enclosed pg no. 62 & 63) records that coupon rate of dividend to be 12%. The issue of unpaid dividend is irrelevant and non-material to the issue under consideration.

Examination of the evidences furnished by the assessee as well as the said MFPL in the course of asst. proceedings brings out the fact that the assessee has issued 12% redeemable preference shares to MFPL. The preference shares have been allotted with fixed coupon rate of 12% (cumulative) with tenure of 5 years. The assessee by way of issue of 12% redeemable preference shares has in fact borrowed Rs.8,71,00,000/- comprising of preference shares issued at face value of Rs. 10/- per share and share premium of Rs.

240/- per share. At the end of the 5 year tenure the redemption amount would be Rs.15,36,44,400/-. The discounted value of this amount with discounting factor of 12% is Rs.8,71,81,959/-. The assessee has issued the preference shares to a private limited company after compliance with all the procedural formalities as laid down by the Companies Act. Relevant documents were filed with the AO and have also been perused by me. The transaction is through banking channels. The valuation of preference shares is supported by a valuation report dt. 23.02.2014 from Khusboo Jain & Associates, CAs who have determined the fair value of the redeemable preference shares on the valuation date. The AO in the course of asst. proceedings (para 5.1/pg no. 3 & 4 of the asst order) has issued notice u/s 133(6) to the investor company seeking various details with regards to the investment by way of preference shares in the assessee company. The said MFPL has replied to the notice u/s. 133(6) and the 17 questions put to it by the AO. The questions as well as the replies of the said MFPL stands reproduced at para 5.1/pg no. 3 & 4 of the asst. order. The said MFPL vide reply to the AO has filed the following details/evidences with the Assessing Officer.

- (i) Memorandum and Articles of Association
- (ii) Copy of audited accounts for 3 asst. years
- (iii) Details of share holding pattern
- (iv) Bank statements
- (v) Ledger account of the assessee in its books of accounts
- (vi) Board resolution authorize investment by way of preference shares
- (vii) Preference shares certificate
- (viii) Explanation with source of funds for investment in preference shares.

The assessee as well as the investor company has filed evidences with regards to vestment in preference shares. The investor company has categorically confirmed the investment in the assessee company in response to enquiries made by the AO. Necessary documents in support of the transaction including documents filed before the Registrar of companies have been produced. In such circumstances, the assessee cannot be said to have failed to discharge the onus placed upon him by section 68 of the Act. It is not the case of the AO that the investor company is not creditworthy to advance the necessary funds. The identity he investor company stands established by the ITR filed and other statutory documents with regards to the said company available on record. The investor company in response to the enquiry by the AO has admitted to the investment in preference shares with explanation about mature of its business. Genuineness of the transaction cannot therefore be doubted.

The Hon. Bombay high court in the case of CIT-vs- Orchid Industries Pvt. Ltd. ITA No. 1433 of 2014 dt. 5th July 2017 (Bom), has held that where the assessee H produced sufficient evidences to support the allotment of shares, addition u/s 68 of Act was not justified. The Hon. Bombay high court in the case of CIT-vs-Green Is Ltd., 98 CCH 42 (Bom) (2017), has held that the share premium has to be judged on touch tone of section 68 with regards to genuineness of transaction, capacity of subscriber and identity. Similar view has been taken by the Hon. Bombay High

Court the case of CIT-vs-Gagandeep Infrastructure Pvt. Ltd., 80 taxmann.com 272 (Bom (2017). Considering the evidences filed by the assessee as well as the investor com with regards to the issue or preference shares, it cannot be said that the onus placed by Section 68 has not been discharged. In such circumstances, the transaction cannot be disputed on the basis of surmises and presumptions. In the present case, there are no concrete evidences disputing the claim made by the assessee/investor company. I accordingly hold that the assessee has adequately discharged the onus placed by section 68 of the Act. Accordingly, addition of Rs. 8,71,00,000/- made u/s 68 of the Act, on account of amount received on allotment of preference shares is deleted. Ground nos. 1 to 4 of the original grounds of appeal stand allowed.

In respect of the additional ground of appeal, the AO has taken an alternate plea that the entire share premium of Rs. 8,36,16,000/- (348400 * 240/- per share) is required to be considered as deemed income under the provisions of sec. 56(2)(viib) of the Act. The AO has argued that the assessee has received share premium exceeding the fair market value of such shares on the date of allotment. The AO for this purpose has relied upon the provisions of Rule 11UA(1)(c) of the IT Rules, dealing with valuation of fair market value of unquoted shares. The relevant provisions of Rule 11UA(1)(c) read as under.

"11UA. 7[(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 —

(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 such valuation.]"

The above rule provide that the value of unquoted shares other than equity shares (which will include preference shares) would be the price such shares would fetch in the open market on the valuation date. It is also provided that the assessee may back the valuation by a report from an accountant. In the present case, the assessee has issued preference shares having fixed coupon rate of 12% (cumulative) with tenure of 5 years. Accordingly, the present discounted value of the redemption amount at the end of the 5 year tenure is the fair market value of the preference shares. The assessee has obtained valuation report on 23.02.2014 from M/s. Khusboo Jain & Associates; CA's who have on the basis of discounted cash flow method determined the fair value of the preference shares. The AO in the asst. order has stated that discounted cash flow method is not appropriate for determining the fair value of preference shares as per Rule 11UA, which according to AO prescribes that such shares should be valued as per price that the share would fetch, if sold in the open market on the valuation date. I do not find the arguments of the AO justifiable. Rule 11UA(1)(c) prescribes that the value of such shares shall be the estimated price it would fetch if sold in the open market as on valuation date. The Rule further suggests that the assessee may obtain a

report from a merchant banker or an accountant in respect of such valuation. The preference shares issued by the assessee are redeemable after a fixed tenure of 5 years, with a fixed coupon rate of 12%. Naturally, the fair market value of such shares redeemable after a fixed tenure with a fixed coupon rate would be the discounted value of redemption amount as on date. This is what is done by the assessee who has supported the valuation by a report from the accountant. I find that the valuation of preference shares issued by the assessee to MFPL on the basis of discounted value of redemption amount is appropriate as per the provisions of Rule 11UA(1)(c). The deeming provisions of section u/s 56(2)(viib) of the Act would not get attracted in such circumstances. The additional ground raised by the assessee is accordingly allowed.”

9. We notice that the AO has made detailed enquiries with MFPL, being the subscriber of the preference shares and it has duly replied to all the queries posed by the AO. Further, it has also furnished various evidences available with it. We notice that the AO did not disprove the submissions and evidences so furnished by MFPL. It is well established proposition of law that the initial onus to prove the cash credit is placed upon the assessee, i.e., the assessee has to prove three main ingredients, viz., the identity of the creditor, credit worthiness of the creditor and the genuineness of the creditor. We notice that the Ld CIT(A) has given a specific finding that the assessee has discharged the initial onus placed upon the assessee u/s 68 of the Act. We notice that the AO has failed to disprove the onus discharged by the assessee, in which case, the AO could not have made the addition u/s 68 of the Act. Accordingly, we are of the view that the Ld CIT(A) was justified in deleting the addition made u/s 68 of the Act.

10. With regard to the addition made u/s 56(2)(viib) of the Act, we notice that the provisions of Rule 11UA(1)(c) do not prescribe any specific method for valuing preference shares. The valuation of preference shares under Discounted Free cash flow method is one of the recognized methods and there is nothing in the provisions that the said method should not be used. Hence we are of the view that the Ld CIT(A) was justified in deleting the addition made u/s 56(2)(viib) of the Act. Accordingly, we confirm the order passed by Ld CIT(A).

11. In the result, the appeal filed by the revenue is dismissed.

Order pronounced in the open court on 15.07.2022.

Sd/-
(RAHUL CHAUDHARY)
JUDICIAL MEMBER

Sd/-
(B.R. BASKARAN)
ACCOUNTANT MEMBER

Mumbai; Dated : 15/07/2022

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent
3. The CIT(A)
4. CIT
5. DR, ITAT, Mumbai
6. Guard File.

//True Copy//

PS

BY ORDER,

(Assistant Registrar)
ITAT, Mumbai