

IN THE INCOME TAX APPELLATE TRIBUNAL
[DELHI BENCH "G" NEW DELHI]

BEFORE SHRI NARENDRA KUMAR BILLAIYA, ACCOUNTANT MEMBER
AND
SHRI CHALLA NAGENDRA PRASAD, JUDICIAL MEMBER

आ.अ.सं .I.T.A Nos. 9824/Del/2019
निर्धारण वर्ष/Assessment Years : 2015-16

M/s. Thinkstations Learning Private Limited, P-1, Ground Floor, Hauz Khas Enclave, New Delhi - 110 016.	<u>बनाम</u> Vs.	ACIT, Circle : 8 (1) New Delhi.
PAN No. AACCE6786C		

A N D

आ.अ.सं .I.T.A No. 7345/Del/2019
निर्धारण वर्ष/Assessment Year : 2016-17

M/s. Thinkstations Learning Private Limited, P-1, Ground Floor, Hauz Khas Enclave, New Delhi - 110 016.	<u>बनाम</u> Vs.	ACIT, Circle : 25(1) New Delhi.
PAN No. AACCE6786C		
अपीलार्थी/ Appellants		प्रत्यर्थी/ Respondents

निर्धारितकीओरसे / Assessee by :	Shri Yogesh Jagia, Advocate;
राजस्वकीओरसे / Department by :	Shri Jitender kale, Sr. D. R.;

सुनवाईकीतारीख/ Date of hearing :	04.05.2023
उद्घोषणाकीतारीख/Pronouncement on :	04.07.2023

आदेश / O R D E R

PER C. N. PRASAD, J. M. :

1. These two appeals are filed by the assessee against different orders of the ld. Commissioner of Income Tax (Appeals)-3 [hereinafter referred to CIT (Appeals)] New Delhi for assessment years 2015-16 and 2016-17 in sustaining the addition made by the Assessing Officer under section 56(2)(viib) of the Income Tax Act, 1961 (the Act) in respect of share premium received by the assessee.

2. First we take up the appeal of the assessee in ITA. No, 7345/Del/2019 for assessment year 2015-16. Brief facts are that the assessee, a Pvt. Ltd. company filed return of income on 1.01.2016 declaring loss of Rs.1,07,38,216/-. Assessment was completed under section 143(3) of the Act on 31.12.2017 determining the income of assessee at Rs.78,33,064/-. In the course of assessment proceedings the Assessing Officer noticed that assessee allotted 1,42,856 equity shares of Rs.10/- each at a premium of Rs.130/- per share. The assessee was asked to submit the valuation report and the report was submitted. The Assessing Officer noticed that the assessee followed Discounted Cash Flow (DCF) Method for valuation of share price. The Assessing Officer

referring to the provisions of section 56(2)(viib) and the explanation he was of the view that assessee has to consider the valuation whichever is higher between (i) the valuation according to Rule 11UA of Income Tax Rules or (ii) the value of shares to the satisfaction of the Assessing Officer. The Assessing Officer was of the view that DCF method followed by the assessee for the valuation of shares is nothing but assumption for projected of cash flow and stated to be not only unjustified and un-related to the actual financial position of the assessee company but also without any rational basis. Thus, the Assessing Officer is not satisfied with the valuation of shares submitted by the assessee, he himself has determined the fair market value of the share at Rs.5.80 Paise and accordingly an amount of Rs.1,85,71,280/- was added as income from other sources under section 56(2)(viib) of the Act.

3. On appeal the ld. CIT (Appeals) sustained the action of the Assessing Officer observing that the Assessing Officer is competent within his powers to look into the fact whether the valuation report is fair and reasonable and the assessee has failed to justify the premium of Rs.130/- per share charged on allotment of un-quoted equity shares.

4.1 Before us the ld. Counsel for the assessee submitted that the appellant a private limited company during the year under appeal was engaged in the business of providing education in an effective manner by using integrated education and teacher training company, focused on making education engaging and effective in the 21st century and is focusing to build a stronger foundation to empower children with skills to compete in a rapidly changing

world. Appellant filed its return of income under section 139(1) of Income Tax Act, 1961 in short "Act" on 01/01/2016 declaring loss of Rs.1,07,38,216. Return filed was selected under CASS for scrutiny and the case was taken up.

4.2 Ld. Assessing officer on 19/04/2016 issued notice under section 143(2) of the act along with notice under section 142(1). Subsequent notices were issues and appellant attended the hearings from time to time and submitted the replies

4.3 Ld. Assessing officer issued a final show cause notice purported to be dated 20/12/2017 sent by speed post and received by assessee on 25/12/2017 being fag end of the limitation period posted in relation to share capital and share premium received during the year. Having given such a short notice, the appellant with great difficulties, in response to the show cause notice, filed its reply vide letter dated 27/12/2017.

4.4 For share premium, the appellant during the subject Assessment Year has issued share capital and has received the Share premium. The amount of share capital allotted is 142856 equity share at face value of Rs.10/- and premium at Rs.130/- per share amounting to Rs.1,85,71,280/-. Appellant has adopted the discounted cash flow method (DCF) by which the share premium of the shares was determined at Rs 130/- per share in addition to face value of Rs.10/- by relying on the explanation (a) (i) in section 56(viib) of the Act where option is to determine the valuation by applying Rule 11 UA and carry valuation under DCF method as per clause (b) of said rule, in case assets of the company are not substantiated by factors such as Goodwill, Know-

how, patents, copy right etc. (explanation applicable herein is (a) (ii) of section 56(viib). However, assessing officer, giving a complete go-bye to the provisions of the Act, considered income under section 56(2)(viib) amounting to Rs.97,62,947/- (i.e. share premium) by applying net asset liability method mentioned under rule 11UA. The fair market value of share as per Ld. Assessing Officer is Rs.5.85 per share.

5.1 Ld. Counsel referred to Rule 11UA (2) of Income Tax Rules which Rule is as under:-

“Notwithstanding anything contained in sub-clause (b) of clause (c) of sub-rule (1),

“(2) 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) the fair market value of unquoted equity shares =

$$\frac{(A-L)}{\quad} \times (PV),$$

$$\quad (PE)$$

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.“

5.2 Referring to Rule 11UA (2) it is submitted that the appellant has exercised the option (b) as mentioned in rule 11UA by using Discounted Free Cash Flow method which has been rejected by learned AO by applying (a) The difference between option (b) and (a) has been considered as Income.

5.3 Ld. Counsel submits that the method of valuation of unlisted equity shares is primarily that of book value for the purposes of clauses (vii) and (viia) of section 56(2), while DCF method is also permissible for the purposes of clause (viib) of section 56(2). The purpose of certification of DCF valuation by a merchant banker or a Chartered Accountant is to ensure that the valuation is fair and reasonable, and on the basis of established valuation methodologies. Such valuation is by an expert on the subject, which an Assessing Officer is not expected to be.

6. The ld. Counsel for the assessee further submitted that the method adopted by the assessee is one of the recognized methods for valuation of shares and there is no justification in discarding this method by the Assessing Officer simply stating that the valuation is full of assumptions and surmises for projected cash flow, unjustified and un-related to the actual financial position of the assessee and without any rational basis. The ld. Counsel for the assessee placing reliance on the decision of the Hon'ble Delhi High Court in the case of Pr. CIT Vs. Cinestaan Entertainment Pvt. Ltd. which is placed at page Nos. 1 to 8 of the paper book, submits that this method has been accepted as one of the recognized methods and strongly placed reliance on the decision of the Hon'ble Delhi High Court.

7. On the other hand, the ld. DR placed reliance on the order of the ld. CIT (Appeals).

8. Heard rival submissions perused the orders of the authorities below. The assessee during the year under consideration

issued 1,42,856 equity shares at face value of Rs.10/- for premium of Rs.130/- per share amounting to Rs.1,85,71,280/-. The assessee adopted the DCF method by which share premium of the shares was determined at Rs.130/- per share in addition to the face value of Rs.10/-. However, the Assessing Officer discarded the method adopted by the assessee and he adopted net assessed liability method and determined the fair market value of shares at Rs.5.80 per share. Thus, the Assessing Officer treated the share premium issued by the assessee of Rs.1,85,71,280/- as income from other sources under section 56(2)(viib) of the Act. The contention of the assessee is that the method adopted by the assessee, namely, DCF method is one of the recognized methods and it cannot be discarded. It is also the contention of the assessee that once a particular method is adopted by the assessee at its option, which is recognized method, the Assessing Officer cannot adopt a different method. The Id. Counsel submits that in this case the assessee had opted only prescribed method of fair market value as per DCF valuation of an accountant under clause (b) of Rule 11UA and, therefore, there is no justification in adopting alternate method as provided in clause (a) of Rule 11UA read with section 56(2)(viib) of the Act. The Id. Counsel also contended that the shares subscribed by the parties are not related to the assessee and the genuineness of the investment is not doubted.

9. We observe that the Hon'ble Delhi High Court in the case of Pr. CIT Vs. Cinestaan Entertainment Pvt. Ltd. [433 ITR 82 (Del)] an identical issue came up before the Hon'ble court and the Hon'ble court held that the shares had not been subscribed to by any sister

concern or closely related person but by outsider investors. It was further held that the methodology adopted was a recognized method of valuation and the Revenue was unable to show that the assessee adopted a demonstrably wrong approach or that the method of valuation was made on a wholly erroneous basis or that the method of valuation or that it committed a mistake which went to the root of the process. While holding so the Hon'ble Delhi High Court held as under:-

“8. We have heard and duly considered the arguments and contentions advanced by the learned counsel for both the parties.

9. In the present case, the Respondent-Assessee has received share premium from various subscribers/equity partners. These funds were required by the Respondent - Assessee for film production. The shares were issued based on the valuation received from the prescribed expert i.e., a Chartered Accountant who used the DCF method which is one of the methods stipulated under Section 56(2)(viib) read with Rule 11UA (2)(b). Based on the valuation report dated 15.12.2014, the Respondent-Assessee equity partners at a premium as per the following table:-

S. No.	Name of equity partner	Date of issue	No. of shares	Premium (Rs.) per share	Amount of premium (Rs.)
1.	Shri Anand Mahindra	06.01.2015; 23.02.2015	4,15,385	1949	80,95,85,365/-
2.	Shri Rakesh Jhunjunwala	24.03.2015	19,207	2602	4,99,80,793/-
3.	Shri Radhakishan Damani	24.03.2015	19,207	2602	4,99,80,793/-
	Total :		4,53,799		90,95,46,200/-

10. The AO has disregarded the valuation report of the Respondent-Assessee primarily on the ground that the projections of revenue as considered for the purpose of valuation do not match the actual revenues of subsequent years. The Assessing Officer has made additions based on the assumption that the Respondent-Assessee made no efforts to achieve the projection as made out in the valuation report and therefore the share premium received by the Respondent-Assessee is without any basis and contrary to provisions of Section 56(2)(viib) read with Section 2(24) (xvi) of the Act. Further, the AO held that the Respondent-Assessee has failed to submit any basis of projection. He also held the view that in order to achieve the said projection, the Respondent - Assessee should have invested the share premium amount to earn certain income/return and whereas the Respondent-Assessee made investments in zero percent debentures of its associate company and therefore the basic substance of receiving a high premium is not justified.

11. We note that in the instant case, the AO had issued notice under Section 133 (6) to all the investors to seek confirmation, information and documents pertaining to the issuance of shares. Further, the venture agreement between the Respondent- Assessee and the investors was also filed before the AO. The learned ITAT thus, after due consideration of the record, concluded that neither the identity, nor the creditworthiness and genuineness of the investors and the pertinent transaction could be doubted. This fact stood fully established, before the Assessing Officer and has not been disputed or doubted. Therefore, the nature and source of the credit stood accepted.

12. In this factual background, the learned ITAT then proceeded to examine whether the AO after invoking the deeming provision under Section 56(2)(viib) could have determined the FMV of the premium on the shares issued at nil after rejecting the valuation report given by the Chartered Accountant based on one of the prescribed methods under the Rules adopted by the valuer. On this aspect, after examining the statutory provisions and the factual position, the ITAT inter-alia observed as under:-

"32. What is seen here is that, both the authorities have questioned the assessee's commercial wisdom for making the investment of funds raised in 0% compulsorily convertible debentures of group companies. They are trying to suggest

that assessee should have made investment in some instrument which could have yielded return/profit in the revenue projection made at the time of issuance of shares, without understanding that strategic investments and risks are undertaken for appreciation of capital and larger returns and not simply dividend and interest. Any businessman or entrepreneur, visualise the business based on certain future projection and undertakes all kind of risks. It is the risk factor alone which gives a higher return to a businessman and the income tax department or revenue official cannot guide a businessman in which manner risk has to be undertaken. Such an approach of the revenue has been judicially frowned by the Hon'ble Apex Court on several occasions, for instance in the case of SA Builders, 288 ITR 1 (SC) and CIT v. Panipat Woolen and General Mills Company Ltd., 103 ITR 66 (SC). The Courts have held that Income Tax Department cannot sit in the armchair of businessman to decide what is profitable and how the business should be carried out Commercial expediency has to be seen from the point of view of businessman. Here in this case if the investment has made keeping assessee's own business objective of projection of films and media entertainment, then such commercial wisdom cannot be questioned. Even the prescribed Rule 11UA(2) does not give any power to the Assessing Officer to examine or substitute his own value in place of the value determined or requires any satisfaction on the part of the Assessing Officer to tinker with such valuation. Here, in this case, Assessing Officer has not substituted any of his own method or valuation albeit has simply rejected the valuation of the assessee.

33. Section 56(2)(viib) is a deeming provision and one cannot expand the meaning of scope of any word while interpreting such deeming provision. If the statute provides that the valuation has to be done as per the prescribed method and if one of the prescribed methods has been adopted by the assessee, then Assessing Officer has to accept the same and in case he is not satisfied, then we do not find any express provision under the Act or rules, where Assessing Officer can adopt his own valuation in DCF method or get it valued by some different Valuer. There has to be some enabling provision under the Rule or the Act

where Assessing Officer has been given a power to tinker with the valuation report obtained by an independent valuer as per the qualification given in the Rule 110. Here, in this case, Assessing Officer has tinkered with DCF methodology and rejected by comparing the projections with actual figures. The Rules provide for two valuation methodologies, one is assets based NAV method which is based on actual numbers as per latest audited financials of the assessee company. Whereas in a DCF method, the value is based on estimated future projection. These projections are based on various factors and projections made by the management and the Valuer, like growth of the company, economic/market conditions, business conditions, expected demand and supply, cost of capital and host of other factors. These factors are considered based on some reasonable approach and they cannot be evaluated purely based on arithmetical precision as value is always worked out based on approximation and catena of underline facts and assumptions. Nevertheless, at the time when valuation is made, it is based on reflections of the potential value of business at that particular time and also keeping in mind underline factors that may change over the period of time and thus, the value which is relevant today may not be relevant after certain period of time. Precisely, these factors have been judicially appreciated in various judgments some of which have been relied upon by the Id. Counsel, for instance:

i) Securities & Exchange Board of India [2015 ABR 291]

"48.6 Thirdly, it is a well settled position of law with regard to the valuation that valuation is not an exact science and can never be done with arithmetic precision. The attempt on the part of SEBI to challenge the valuation which is by its very nature based on projections by applying what is essentially a hindsight view that the performance did not match the projection is unknown to the law on valuations. Valuation being an exercise required to be conducted at a particular point of time has of necessity to be carried out on the basis of whatever information is available on the date of the

valuation and a projection of future revenue that valuer may fairly make on the basis of such information."

ii) Rameshwaram Strong Glass Pvt. Ltd. Vs. ITO [2018-TIOL-1358)

"4.5.2. Before examining the fairness or reasonableness of valuation report submitted by the assessee we have to bear in mind the DCF Method and is essentially based on the projections (estimates) only and hence these projections cannot be compared with the actuals to expect the same figures as were projected. The valuer has to make forecast on the basis of some material but to estimate the exact figure is beyond its control. At the time of making a valuation for the purpose of determination of the fair market value, the past history may or may not be available in a given case and therefore, the other relevant factors may be considered. The projections are affected by various factors hence in the case of company where there is no commencement of production or of the business, does not mean that its share cannot command any premium. For such cases, the concept of start-up is a good example and as submitted the income-tax Act also recognized and encouraging the start-ups.

iii) DQ (International) Ltd. Vs. ACIT (ITA 151/Hyd/2015)

"10. In our considered view, for valuation of an intangible asset only the future projections along can be adopted and such valuation cannot be reviewed with actuals after 3 or 4 years down the line. Accordingly, the grounds raised by the assessee are allowed".

34. The aforesaid ratios clearly endorsed our view as above. In any case, if law provides the assessee to get the valuation done from a prescribed expert as per the prescribed method, then the same cannot be rejected because neither the Assessing Officer nor the assessee have been recognized as expert under the law.

35. There is another very important angle to view such cases, is that, here the shares have not been subscribed by any sister concern or closely related person, but by an

outside investors like, Anand Mahindra, Rakesh Jhunjhunwala, and Radhakishan Damania, who are one of the top investors and businessman of the country and if they have seen certain potential and accepted this valuation, then how AO or Ld. CIT (Appeals) can question their wisdom. It is only when they have seen future potentials that they have invested around Rs.91 crore in the current year and also huge sums in the subsequent years as informed by the Id. counsel. The investors like these persons will not make any investment merely to give dole or carry out any charity to a startup company like, albeit their decision is guided by business and commercial prudence to evaluate a startup company like assessee, what they can achieve in future. It has been informed that these investors are now the major shareholder of the assessee company and they cannot become such a huge equity stock holder if they do not foresee any future in the assessee company. In a way Revenue is trying to question even the commercial prudence of such big investors like. According to the Assessing Officer either these investors should not have made investments because the fair market value of the share is Nil or assessee should have further invested in securities earning interest or dividend. Thus, under these facts and circumstances of the case, we do not approve the approach and the finding of the Id. Assessing Officer or Id. CIT(A) so to take the fair market value of the share at 'Nil' under the provision of Section 56(2)(viib) and thereby making the addition of Rs. 90.95 crores. The other points and various other arguments raised by the Id. counsel which kept open as same has been rendered.

36. Other grounds are either consequential or have become academic, hence same are treated as infructuous. In the result appeal of the appellant assessee is allowed.”

13. From the aforesaid extract of the impugned order, it becomes clear that the learned ITAT has followed the dicta of the Hon'ble Supreme Court in matters relating to the commercial prudence of an assessee relating to valuation of an asset. The law requires

determination of fair market values as per prescribed methodology. The Appellant-Revenue had the option to conduct its own valuation and determine FMV on the basis of either the DCF or NAV Method. The Respondent-Assessee being a start-up company adopted DCF method to value its shares. This was carried out on the basis of information and material available on the date of valuation and projection of future revenue. There is no dispute that methodology adopted by the Respondent-Assessee has been done applying a recognized and accepted method. Since the performance did not match the projections, Revenue sought to challenge the valuation on that footing. This approach lacks material foundation and is irrational since the valuation is intrinsically based on projections which can be affected by various factors. We cannot lose sight of the fact that the valuer makes forecast or approximation based on potential value of business. However, the underline facts and assumptions can undergo change over a period of time. The Courts have repeatedly held that valuation is not an exact science, and therefore cannot be done with arithmetic precision. It is a technical and complex problem which can be appropriately left to the consideration and wisdom of experts in the field of accountancy, having regard to the imponderables which enter the process of valuation of shares. The Appellant-Revenue is unable to demonstrate that the methodology adopted by the Respondent-Assessee is not correct. The Assessing Officer has simply rejected the valuation of the Respondent-Assessee and failed to provide any alternate fair value of shares. Furthermore, as noted in the impugned order and as also pointed out by Mr. Vohra, the shares in the present scenario have not been subscribed to by any sister concern or closely related person, but by outside investors. Indeed, if they have seen certain potential and accepted this valuation, then Appellant-Revenue cannot question their wisdom. The valuation is a question of fact which would depend upon appreciation of material or evidence. The methodology adopted by the Respondent-Assessee, accepted by the learned ITAT, is a conclusion of fact drawn on the basis of material and facts available. The test laid down by the Courts for interfering with the findings of a valuer is not satisfied in the present case, as the Respondent-Assessee adopted a recognized method of valuation and Appellant-Revenue is unable to show that the assessee adopted a demonstrably wrong approach, or that the method of valuation was made on a wholly erroneous basis, or that

it committed a mistake which goes to the root of the valuation process.

14. In view of the foregoing, we find that the question of law urged by the Appellant - Revenue is purely based on facts and does not call for our consideration as a question of law.”

10. The ratio of the decision of the Hon’ble Delhi High Court squarely applies to the facts of the assessee’s case. Thus, respectfully following the said decision, we hold that the Assessing Officer erred in discarding the DCF method of valuation of shares adopted by the assessee. Thus, we reverse the order of the Id. CIT (Appeals) and direct the Assessing Officer to delete the addition made under section 56(2)(viib) of the Act. The ground raised by the assessee on this issue is allowed.

11. Coming to appeal of the assessee for assessment year 2016-17 the ground taken by the assessee is identical to the ground of appeal for assessment year 2015-16. Facts being identical, the decision taken therein for assessment year 2015-16 applies mutatis mutandis to the appeal of the assessee for assessment year 2016-17. We order accordingly.

12. In the result, both the appeals of the assessee are allowed.

Order pronounced in the open court on : 04/07/2023

Sd/-
(N. K. BILLAIYA)
ACCOUNTANT MEMBER

Sd/-
(C. N. PRASAD)
JUDICIAL MEMBER

Dated : 04/07/2023

MEHTA

Copy forwarded to :

1. Appellants;
2. Respondents;
3. CIT
4. CIT (Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi.

Date of dictation	27.06.2023
Date on which the typed draft is placed before the dictating member	28.06.2023
Date on which the typed draft is placed before the other member	04.07.2023
Date on which the approved draft comes to the Sr. PS/ PS	04.07.2023
Date on which the fair order is placed before the dictating member for pronouncement	04.07.2023
Date on which the fair order comes back to the Sr. PS/ PS	04.07.2023
Date on which the final order is uploaded on the website	04.07.2023
Date on which the file goes to the Bench Clerk	04.07.2023
Date on which the file goes to the Head Clerk	
The date on which the file goes to the Assistant Registrar for signature on the order	
Date of dispatch of the order	