

IN THE INCOME TAX APPELLATE TRIBUNAL

"C" BENCH, MUMBAI

BEFORE SHRI B.R. BASKARAN, ACCOUNTANT MEMBER AND

SHRI SANDEEP SINGH KARHAIL, JUDICIAL MEMBER

ITA no.317/Mum./2020

(Assessment Year : 2016-17)

PNP Maritime Services Pvt. Ltd.
A-5, Ionic, 18, Arthur Bunder Road
Colaba, Mumbai 400 005 Appellant
PAN – AABCP8020D

v/s

Dy. Commissioner of Income Tax
Circle-3(2)(2), Mumbai Respondent

ITA no.668/Mum./2020

(Assessment Year : 2016-17)

Dy. Commissioner of Income Tax
Circle-3(2)(2), Mumbai Appellant

v/s

PNP Maritime Services Pvt. Ltd.
A-5, Ionic, 18, Arthur Bunder Road
Colaba, Mumbai 400 005 Respondent
PAN – AABCP8020D

Assessee by : Shri Nishant Thakkar a/w
Ms. Jasmin Amlsadvla
Revenue by : Shri R.A. Dhyani and Shri H.M. Bhatt

Date of Hearing – 07/12/2023

Date of Order – 19/12/2023

ORDER

PER SANDEEP SINGH KARHAIL, J.M.

The present cross appeals have been filed challenging the impugned order dated 06/11/2019, passed under section 250 of the Income Tax Act,

1961 (*"the Act"*) by the learned Commissioner of Income Tax (Appeals)-8, Mumbai, [*"learned CIT(A)"*], for the assessment year 2016-17.

2. In its appeal, the Revenue has raised the following grounds:-

"1. Whether on the facts and in the circumstances of the case and in law, the Ld.CIT(A) is justified in deleting the disallowance made u/s 56(2)(viib) of the Act without appreciating the fact that shares have been allotted on premium of Rs. 590 only on the basis of valuation report which was not supported by the documentary evidences?"

2. Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) is justified in deleting the disallowance made u/s 56(2)(viib) of the Act without appreciating the fact that there was no conformihl between the projected financials of the company as reported in valuation report with the actual financials for A. Y. 2017-18?.

3. Whether on the facts and in the circumstances of the case and in law, the Ld.CIT(A) is justified in deleting the disallowance made u/s 36(1)(iii) of the Act without appreciating the fact that the borrowed funds were utilised for making non business advances?"

4. Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) is justified in deleting the disallowance made u/s 36(1)(iii) of the Act without appreciating the fact that the borrowed funds were utilised for making new investment in zero coupon redeemable non convertible debentures and not for purpose of business?"

5. The appellant prays that the order of CIT(A) on the above grounds be set aside and that of Assessing Officer be restored.

6. The appellant craves leave to amend, alter, delete or add grounds which may be necessary."

3. While the assessee has raised the following grounds in its appeal:-

"1. The Hon'ble CIT (Appeals) has erred in law and facts and circumstances of the case by upholding the disallowance of Rs.4,41,60,557/- u/s 36(1)(iii) of the Act.

2. The Hon'ble CIT (Appeals) has erred in law and facts and circumstances of the case by ignoring the fact that Appellant Company has given interest free Security Deposits of Rs.100,12,02,392 for business purposes and further erred in presuming that the funds were given out of the borrowed funds thereby making a pro-rata disallowance of Interest Expenses u/s 36(1)(iii) of the Act.

3. *The Hon'ble CIT(Appeals) has erred in law and facts and circumstances of the case by ignoring the fact that the Appellant Company has Interest free funds of Rs.119,03,36,224/- (Own Funds) which are presumed to be used for making an Interest Free Security Deposits of Rs.100,12,02,392/- and accordingly no disallowance under section 36(1)(iii) of the Act is attracted following the decision of jurisdictional Bombay High Court in case of Reliance Utilities and Power Ltd. v/s Commissioner of Income-tax (2009) 178 Taxman 135 (Bombay).*

4. *The Hon'ble CIT(Appeals) has erred in law and facts by confirming the initiation of Penalty proceeding u/s 274 r.w.s. 271(1)(c) of the Act.*

5. *The Hon'ble CIT(Appeals) has erred in law and facts by confirming the levy of interest u/s 234B and 234C of the Act.*

Your Appellant craves leave to add to, alter, amend, delete and/or modify the above grounds of appeal on or before the final date of hearing.

7. *The Appellant prays your honour for allowing the appeal."*

4. The issue arising in grounds no. 1 and 2, raised in Revenue's appeal, pertains to the deletion of disallowance made under section 56(2)(viib) of the Act.

5. The brief facts of the case pertaining to this issue, as emanating from the record, are: The assessee is engaged in giving port and port-related logistics services at PNP Port, Dharmtar, District Raigad, Maharashtra. For the year under consideration, the assessee filed its return of income on 16/10/2016 declaring a total income of Rs. 24,77,23,700. The return filed by the assessee was selected for scrutiny and statutory notices under section 143(2) as well as section 142(1) were issued and served on the assessee. From the perusal of the financial statement of the assessee, it was observed that the assessee has issued 10,00,001 equity shares of Rs. 10 each paid to Shapoorji Pallonji Company Private Limited at a premium of Rs. 590 per share. In pursuance of this offer, the assessee has issued 10,00,001 equity

shares at an issue price of Rs. 600 per share. (of which Rs. 590 per share was towards the securities premium). Thus the assessee received a securities premium of Rs. 58,99,99,990. During the assessment proceedings, the assessee was asked to furnish the details of the shareholders from whom the share premium was received. The assessee was also asked to justify the receipt of the share premium along with the necessary documentary evidence. In response, the assessee submitted that it has issued 10,00,001 equity shares of Rs. 10 each fully paid to Shapoorji Pallonji Company Private Limited at a premium of Rs. 590 per share. The assessee also furnished the ledger account, relevant entries in the bank statement, allotment document filed with the ROC and PAN of new shareholders. Further, the assessee provided the copy of valuation report for charging the premium. The Assessing Officer ("AO") vide order dated 26/12/2018 passed under section 143(3) of the Act held that the assessee has not given any justification for charging the premium of Rs. 590 per share by it. The AO compared the Projected Summarised Financials in the valuation report with the return of income filed by the assessee and the financials for the assessment years 2014-15 to 2018-19 and held that the assessee is incurring losses during the assessment year 2018-19. Accordingly, it was held that the assessee has failed to file the supporting documentation to justify the share premium. The AO further held that the assessee is showing a circular transaction with subsidiary company and therefore there is no justification for charging such a huge premium. Accordingly, the AO held that the assessee has not fulfilled any of the conditions laid down under the Explanation to section 56(2)(viib) of

the Act and disallowed an amount of Rs. 58,99,99,990 received by the assessee as a premium on issue of shares to Shapoorji Pallonji Company Private Limited.

6. The learned CIT(A), vide impugned order, allowed the appeal filed by the assessee on this issue and held that there is no explanation by the AO for rejecting the valuation adopted by the assessee and for rejecting the value of shares received by the assessee by applying the Discounted Cash Flow ("DCF") method. The learned CIT(A) further held that the share premium was given by no less than a company of the stature of Shapoorji Pallonji Company Private Limited, which cannot be expected to be charged unjustified over-valuation of shares and who must have invested after doing their due diligence. The learned CIT(A) held that the assessee has submitted the valuation report by an auditor as per Explanation-(a)(ii) to section 56(2)(viib) of the Act, according to which the fair market value of the unquoted shares comes to Rs. 735, however in the present case the assessee has adopted a value of Rs. 600 only which is much less than the fair market value as per the valuation report adopting the DCF method. Accordingly, the learned CIT(A) held that the fair market value of the shares computed by the assessee as per Rule 11UA is correct and deleted the addition of Rs. 58,99,99,990 as share premium under section 56(2)(viib) of the Act. Being aggrieved, the Revenue is in appeal before us.

7. We have considered the submissions of both sides and perused the material available on record. The assessee raised funds through the issue of

equity shares to Shapoorji Pallonji Company Private Limited primarily to invest in his business of logistics, warehousing, storage, and ancillary services at the Port which was owned by Dharamtar Infrastructure Private Limited. This was done to increase the business and value of Port. The investment of Rs. 53,76,70,659 was paid to the shareholders of Dharamtar Infrastructure Private Ltd. for acquiring 65% (approx.) of the shares. Prior to the acquisition, the assessee had 35% (approx.) of the shares. With the acquisition of a further 65% (approx.) Dharamtar Infrastructure Private Ltd. became a 100% subsidiary of the assessee. The shares were issued based on the valuation by the Chartered Accountant by using the DCF method which is one of the prescribed methods under section 56(2)(viib) of the Act read with Rule 11UA(2)(b). Before proceeding further, it is pertinent to note the relevant provisions of section 56(2)(viib) of the Act, which reads as under:-

"(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:"

8. Therefore, as per the provisions of section 56(2)(viib) of the Act, if the consideration received for the issue of shares of a company in which the public is not substantially interested exceeds the fair value of such shares, the aggregate consideration as exceeds the fair market value shall be chargeable to income tax under the head "*income from other sources*". Explanation to the aforesaid section further defines "*fair market value*", as under:-

"(a) the fair market value of the shares shall be the value—

(i) as may be determined in accordance with such method as may be prescribed; or

(ii) 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;"

9. Undisputedly, Explanation-(a)(ii) to section 56(2)(viib) of the Act is not applicable to the present case. As per Explanation-(a)(i), the fair market value may be determined in accordance with the prescribed method. Rule 11UA(2) of the Rules prescribes Net Asset Value ("NAV") method and DCF method for the determination of the fair market value of the shares for the purposes of sub-clause (i) of clause (a) of the Explanation to section 56(2)(viib) of the Act. Further, under Rule 11UA(2) of the Rules, the assessee has the option to carry out a valuation and determine fair market value as per any of the aforesaid methods.

10. In the present case, it is undisputed that the assessee opted for valuation as per the DCF method and the auditor arrived at the fair market value of Rs. 735 per share. Since the assessee had issued the shares at Rs. 600 (including a premium of Rs. 590), which was lower than the fair market value determined by the auditor on the basis of the DCF method, the assessee claimed that section 56(2)(viib) of the Act is not applicable, as the said section only brings to tax the consideration in excess of the fair market value. In the alternative, during the appellate proceedings before the learned CIT(A), the assessee also furnished the fair market value of the shares at Rs.

410.14 per share as per the NAV method. However, it is evident from the record that the AO neither accepted the valuation report as furnished by the assessee to arrive at the fair market value of the shares on the basis of the DCF method nor pointed out any mistake in the valuation report so furnished by the assessee. Rather, in the present case, the AO treated the value of the premium on the shares at Rs. Nil without following any of the methods prescribed under the relevant Rules. The Hon'ble jurisdictional High Court in *Vodafone M-Pesa Ltd v/s PCIT*, [2019] 92 taxmann.com 73 (Bom.) held that there is certainly no immunity from the scrutiny of the valuation report submitted by the assessee and the AO is entitled to scrutinise the valuation report and determine a fresh valuation either by himself or by calling for a final determination from an independent valuer, however the basis has to be the method adopted by the assessee and it is not open to the AO to change the method of valuation which has been opted for by the assessee under Rule 11UA(2) of the Rules. Therefore, we are of the considered view that the addition made by the AO under section 56(2)(viib) of the Act is not in conformity with the provisions of the statute. Further, we find the decision of the coordinate bench of the Tribunal in *Agro Portfolio Pvt. Ltd. v/s ITO*, [2018] 94 taxmann.com 112 (Delhi-Trib.), relied upon by the learned Departmental Representative, to be factually distinguishable, as in the said decision the AO applied NAV method to determine the fair market value of the shares after doubting the correctness of the result as per DCF method adopted by the taxpayer. However, as noted above, in the present case the

AO did not follow any of the methods prescribed under the relevant Rules for making the impugned addition.

11. It is evident from the record that the AO by comparing the financials of the assessee and "Projected Summarised Financials" in the valuation report noted that the assessee has in fact incurred loss during the assessment year 2018-19. In this regard, it is relevant to note that the Hon'ble Delhi High Court in PCIT v/s Cinestaan Entertainment Pvt. Ltd., [2021] 433 ITR 82 (Delhi) held that the valuer makes a forecast of approximation based on the potential value of business, while the underline facts and assumptions can undergo change over a period of time. The Hon'ble High Court further held that valuation is not an exact science, and therefore cannot be done with arithmetic precision. The relevant findings of the Hon'ble High Court, in the aforesaid decision, are reproduced as under:-

"13.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 AO has simply rejected the valuation of the Respondent-Assessee and failed to provide any alternate fair value of shares."

12. Undoubtedly, section 56(2)(viib) of the Act is an anti-abuse provision brought in the statute to prevent the practice of transferring shares of

specified company for no or inadequate consideration. However, it is pertinent to note that in the present case, the shares of the assessee were subscribed not by a sister concern or any closely related person but by an outside investor. Further, as noted by the learned CIT(A) in paragraph 3.1.13, by no less than a corporate giant called Shapoorji Pallonji group, whose identity, creditworthiness, and genuineness are not doubted by the Revenue. Therefore, we find no infirmity in the impugned order passed by the learned CIT(A) on this issue deleting the addition of Rs. 58,99,99,990 as share premium under section 56(2)(viib) of the Act. Accordingly, grounds no. 1 and 2 raised in Revenue's appeal are dismissed.

13. Since the issue arising in grounds no. 3 and 4, raised in Revenue's appeal, and grounds no. 1-3, raised in assessee's appeal, pertains to disallowance made under section 36(1)(iii) of the Act, therefore these grounds are considered together.

14. The brief facts of the case pertaining to this issue, as emanating from the record, are: During the assessment proceedings, from the perusal of the financial statement of the assessee it was observed that the assessee has shown borrowed funds of Rs. 163,42,85,721. It was further observed that during the year, the assessee has made new investments of Rs. 59,26,70,650 in subsidiary company and an investment of Rs. 42,80,00,000 in zero coupon redeemable non-convertible secured debentures of PNP Infra Projects Private Limited. Further, the assessee has given a security deposit amount of Rs. 100,12,02,392 to M/s Dharmatar Infrastructure Private Limited, which is a

subsidiary company of the assessee. Further, from the profit and loss account, it was observed that the assessee has debited interest expenditure of Rs. 13,29,10,398 on the interest of term loan from the bank. Accordingly, the assessee was asked to show cause as to why the proportionate disallowance under section 36(1)(iii) of the Act be not made as regards the above investments. In response thereto, the assessee submitted that the term loan from the Bank of Maharashtra was taken for the acquisition of assets and for making payments to the parties during the course of business. It was further submitted that the interest-free advances to related parties were during the course of business and it was out of the funds raised from the issue of shares and the reserve and surplus on hand. The assessee further submitted that the interest-free advances were given to M/s Dharmatar Infrastructure Private Limited, a related party, who had allowed exclusive use of 139 acres of land adjacent to its jetties and a custom-notified area along with Railway siding warehouses and administrative buildings on lease. It was further submitted that the said infrastructure was used for the port operations and only because of the use of the said infrastructure, the assessee could achieve a turnover of Rs. 128.65 crore and earned profit which was offered to tax.

15. The AO, vide assessment order, did not agree with the submissions of the assessee and held that the investments made were clearly not for the purpose of business and profession. It was further held that the assessee has not justified making the investment in zero coupon debentures in PNP Infra Projects Pvt. Ltd. Further, the assessee has not furnished any details as to

why the advances/security deposit of Rs. 100,12,02,392 were given and what was the business purpose. The AO further noted that for the year under consideration, the total funds available with the assessee were Rs. 301,33,99,201 and out of this the interest-bearing borrowed funds were Rs. 182,13,62,977. Further, the total interest-free advances to relatives were Rs. 100,12,02,392, and investment in zero coupon debenture amounting to Rs. 42,80,00,000. Thus, the AO held that possibility of the assessee having utilised the interest-bearing funds for the purpose of giving interest-free advances cannot be denied. As the assessee has not given the details of utilisation of the funds, on a pro-rata basis, it was held that 79% of the interest-free advances/deposits/investment to relatives and others were from the interest-bearing borrowed funds. Therefore, out of the total interest-free advances/deposit/investment of Rs. 142,92,02,392, the loans and advances to an extent of Rs. 112,90,69,889 were considered as from interest-bearing borrowed funds, and as a result interest of Rs. 8,23,14,825 was disallowed on a pro-rata basis under section 36(1)(iii) of the Act.

16. The learned CIT(A), vide impugned order, granted partial relief to the assessee and deleted the disallowance under section 36(1)(iii) of the Act in respect of investment in zero coupon debentures in PNP Infra Projects Pvt. Ltd. As regards the security deposit amount of Rs. 100,12,02,392 given to M/s Dharmatar Infrastructure Private Limited, the learned CIT(A) restricted the disallowance to Rs. 4,41,60,557 on the basis that the percentage of total interest-bearing funds against the total funds available with the assessee is

60.50%. Being aggrieved, both the assessee and the Revenue are in appeal before us.

17. We have considered the submissions of both sides and perused the material available on record. In the present case, it is undisputed that the total funds available with the assessee are Rs. 301,33,99,201 out of which the total interest-bearing funds are Rs. 182,30,62,977. As per the AO, the total interest-bearing funds constitute 79% of the total funds available with the assessee, therefore the AO disallowed the interest expenditure of Rs. 8,23,14,835 on a pro-rata basis under section 36(1)(iii) of the Act. While disallowing the aforesaid interest expenditure, the AO was of the view that investment of Rs. 42,80,00,000 in zero coupon debentures in PNP Infra Projects Pvt. Ltd. and security deposit amount of Rs. 100,12,02,392 given to M/s Dharmatar Infrastructure Private Limited were not for the purpose of business and there is a possibility that the assessee has utilised the interest-bearing funds for the purpose of giving the interest-free advances/deposits/investments to the relatives and others.

18. As per the assessee, the zero coupon debentures of Rs. 42,80,00,000 was pursuant to the Debenture Subscription Agreement and Share Transfer Agreement dated 01/04/2015 with PNP Infra Projects Pvt. Ltd., where under the assessee transferred fixed assets, financial assets, shares and land for a total consideration of Rs. 42,80,88,952 with effect from 01/04/2015. As a consideration in respect of the transfer of assets and liabilities, PNP Infra Projects Pvt. Ltd. issued 428 unlisted non-convertible zero coupon secured

debentures, having a face value of Rs. 10,00,000 each, amounting to Rs. 42,80,00,000 and the balance consideration of Rs. 88,952 was paid in cash to the assessee. As per the assessee, it has recognised the profit arising out of the said transfer agreement amounting to Rs. 5,81,30,080 in the statement of profit and loss account. From the perusal of the financial statement of the assessee, forming part of the paper book on pages 53-54, we find that the assessee made the declaration in respect of transfer of assets and liabilities to PNP Infra Projects Pvt. Ltd. It is evident from the record that after considering the declaration in financial statement of the assessee, the learned CIT(A) deleted the disallowance of interest expenditure under section 36(1)(iii) of the Act in respect of zero coupon debentures. In view of the facts and circumstances as noted above, we find no infirmity in the aforesaid findings of the learned CIT(A) as zero coupon debentures are not an investment by the assessee instead the same is a consideration for the transfer of assets and liabilities to PNP Infra Projects Pvt. Ltd. Accordingly, grounds no. 3 and 4 raised in Revenue's appeal are dismissed.

19. Insofar as interest-free deposit of Rs. 100,12,02,392 given to M/s Dharmatar Infrastructure Private Limited is concerned, as per the assessee the said deposit was made for the use of infrastructure by the assessee for its business purpose. Further, it is the claim of the assessee that only because the said infrastructure was available for its use, the assessee achieved a turnover of Rs. 128.65 crore and earned profit which was offered to tax. However, the AO did not agree with the submissions of the assessee on the basis that the assessee did not furnish any proof that the infrastructure was

used for the port operations with documentary evidence. Further, it was observed that M/s Dharmatar Infrastructure Private Limited was amalgamated with the assessee company.

20. During the hearing, it was submitted that the interest-free advances given to M/s Dharmatar Infrastructure Private Limited were made out of the surplus funds available with the assessee. From the perusal of the Balance Sheet of the assessee for the year ending 31/03/2016, forming part of the paper book on Page-11, we find that the assessee has share capital and reserves and surplus of Rs. 119,03,36,224, which is more than the interest-free advance of Rs. 100,12,02,392 given by the assessee. Since zero coupon debenture amounting to Rs. 42,80,00,000 received from PNP Infra Projects Pvt. Ltd. has already been found to be sale consideration instead of investment as claimed by the Revenue, therefore it is evident that the assessee had sufficient own funds for giving interest-free deposit of Rs. 100,12,02,392 to M/s Dharmatar Infrastructure Private Limited. We find that the Hon'ble Jurisdictional High Court in CIT v/s Reliance Utilities & Power Ltd., [2009] 313 ITR 340 (Bom.), held that if funds are available with the assessee, which are sufficient to meet the investment, then presumption would arise that the investment is made out of funds so available with the assessee and, therefore, no disallowance under section 36(1)(iii) can be made. In view of the above, respectfully following the aforesaid decision, we direct the AO to delete the disallowance made under section 36(1)(iii) of the Act in respect of interest-free advances given to M/s Dharmatar Infrastructure

Private Limited. Accordingly, grounds no. 1-3 raised in assessee's appeal are allowed.

21. Ground No. 5 raised in Revenue's appeal is general in nature and is dismissed in view of our findings on other grounds in Revenue's appeal.

22. Ground No. 4 raised in assessee's appeal pertains to the initiation of penalty proceedings, which is premature in nature. Therefore, the same is dismissed.

23. Ground no. 5 raised in assessee's appeal pertains to the levy of interest under section 234B and section 234C of the Act, which is consequential in nature. Therefore, the same needs no separate adjudication.

24. In the result, the appeal by the Revenue is dismissed, while the appeal by the assessee is partly allowed.

Order pronounced in the open Court on 19/12/2023

Sd/-
B.R. BASKARAN
ACCOUNTANT MEMBER

Sd/-
SANDEEP SINGH KARHAIL
JUDICIAL MEMBER

MUMBAI, DATED: 19/12/2023

Copy of the order forwarded to:

- (1) The Assessee;
- (2) The Revenue;
- (3) The PCIT / CIT (Judicial);
- (4) The DR, ITAT, Mumbai; and
- (5) Guard file.

Pradeep J. Chowdhury
Sr. Private Secretary

True Copy
By Order

Assistant Registrar
ITAT, Mumbai