

आयकर अपीलीय अधिकरण, अहमदाबाद न्यायपीठ "सी", अहमदाबाद ।
IN THE INCOME TAX APPELLATE TRIBUNAL
" C " BENCH, AHMEDABAD

श्री सिद्धार्थ नौटियाल, न्यायिक सदस्य एवं
श्री मकरंद वसंत महादेवकर, लेखा सदस्य के समक्ष।

BEFORE SHRI SIDDHARTHA NAUTIYAL, JUDICIAL MEMBER
AND
SHRI MAKARAND V. MAHADEOKAR, ACCOUNTANT MEMBER

आयकर अपील सं./ITA No.489/Ahd/2020
निर्धारण वर्ष /Assessment Year : 2016-17

The JCIT (OSD) Circle-2(1)(1) Ahmedabad	बनाम/ v/s.	M/s. Magnet Buildtech Pvt.Ltd. 906-907, Indraprasth Corporate Opp. Venus Atlantis Anand Nagar Road Ahmedabad - 380 015
स्थायी लेखा सं./PAN: AAICM 4158 J		
(अपीलार्थी/ Appellant)		(प्रत्यर्थी/ Respondent)
Assessee by :	Shri Vartik Chokshi & Shri Dhrunal Bhatt, ARs	
Revenue by :	Shri Kamlesh Makwana, CIT-DR	

सुनवाई की तारीख/Date of Hearing : 23/07/2024
घोषणा की तारीख /Date of Pronouncement: 25/07/2024

आदेश/ORDER

PER SHRI MAKARAND V. MAHADEOKAR, AM:

This appeal is filed by the Revenue against the order dated 09/07/2020 passed by the Commissioner of Income Tax (Appeals)-32, New Delhi [hereinafter referred to as "CIT(A)" in short] arising out of the assessment order dated 11/12/2018 passed by the Assessing Officer (AO) under section 143(3) of the Income Tax Act, 1961 (hereinafter referred to as "the Act") relevant to the Assessment Year (AY) 2016-17.

Facts of the case:

2. The assessee-company filed its return of income for the A.Y. 2016-17 on 26-09-2016 declaring the total income of Rs.NIL. The return was processed u/s.143(1) of the Act. Later, the case was selected for the limited scrutiny by issuing notices u/s.143(2) and 142(1) of the Act. During the course of assessment proceedings, it was observed by the AO that the assessee-company had issued 7,99,900 Compulsory Convertible Preference Shares of Rs.10/- each at a premium of Rs.990/- per equity share. Accordingly, share capital of company was increased by Rs.79,99,000/- and securities premium by Rs.79,19,01,000/-.

2.1. The assessee was asked to provide details and genuineness of share capital and share premium along with the certificate of Valuer in accordance with section 56(2)(viib) read with Rule 11UA. Based on the Audited balance-sheet of the assessee-company as on 31st March-2015, the AO observed that the Net Asset Value of the share of company was negative (-) Rs.2.10/- per share. To arrive at this value, the AO used paid up capital of Rs.10,00,290/- and Reserves and Surplus of (-) Rs.1,21,398/-. Accordingly, the AO issued a show-cause notice to the assessee to explain why the amount of Rs.79,98,71,290/- should not be added to the income as per provisions of section 56(2)(viib) of the Act. In reply to the show-cause notice, the assessee submitted the valuation certificate, wherein the Valuer considered Discounted Cash Flow Method for valuation of shares in accordance with Rule 11UA of the Income Tax Rules. The AO observed that the Valuer has given some disclaimers in his certificates relating to financial projections of the assessee company. Therefore, a notice u/s.133(6) of the

Act was issued to the Valuer. In reply to the said notice, the Valuer replied that the certificate has been issued on the basis of financial statements provided by the company. He further submitted that the assumptions were validated by an independent technical consultant retained by the company for preparation of detailed project report.

2.2. Not satisfied with the explanations offered by the assessee, the AO added Rs.79,19,01,000/- to the total income u/s 56(2)(viib) of the Act, while doing so, he noted the Valuer has not verified the financial projections from independent source, the assessee-company has declared losses for subsequent years indicating that the projections are far from reality and the financials used by the Valuer are not up to the date of certificate.

2.3. Not satisfied with the order of AO, the assessee filed an appeal before the Ld.CIT(A), who partly allowed the appeal by deleting addition of Rs.79,19,01,000/- made u/s 56(2)(viib) of the Act. The relevant paras from the order are reproduced hereunder for the sake of clarity:

"5.4.3 On merits Mr Verma submitted that the Valuation, having been in accordance the provisions of Law and the Rules prescribed by the CBDT/Legislatures, is the correct one and therefore, FMV is neither against the so called correct parameters nor is exaggerated in value and as submitted hereinbefore, Assessing Officer having no power to reject the valuation and substitute his own method/valuation, this reason is not relevant at all so as to reject the valuation.

*5.4.4 On the point of justification of the method adopted for valuing the 'CCPS' and disclaimer given by the C.A. reference was made to the Para 5.4 of the Appellate Order in case of Appellant's group Company M/s First Class Infrabuild Pvt. Ltd. wherein both these issues had been discussed and decided by the CIT(A)-3 in Appellant's favour by observing that "**The valuer is bound to give disclaimers as the valuer cannot be expected to determine the exact value as the same is not feasible. As already discussed above, the valuer has***

adopted reasonable projections than the optimum figures for generation of revenue and the valuation of shares done by the valuer has got reasonable basis.....". The Ld AR therefore, submitted that these reasons were also vague and cannot be grounds for rejecting the valuation report prepared in accordance with the prescribed provisions of law. I have considered the decision cited by the AR the view taken by the Ld CIT(A) has been supported by various ITATs. The ITAT, Bangalore Bench in the case of *Innovit Payment Solutions Pvt. Ltd., v. ITO [2019] 102 Taxmann.com 59* has held as follows:

"14. In nutshell, our conclusions are as under:-

(1) The AO can scrutinize the valuation report and the if the AO is not satisfied with the explanation of the assessee, he has to record the reasons and basis for not accepting the valuation report submitted by the assessee and only thereafter, he can go for own valuation or to obtain the fresh valuation report from an independent valuer and confront the same to the assessee. But the basis has to be DCF method, and he cannot change the method of valuation which has been opted by the assessee.

(2) For scrutinizing the valuation report, the facts and data available on the date of valuation only has to be considered and actual result of future cannot be a basis to decide about reliability of the projections.

(3) The primary onus to prove the correctness of the valuation Report is on the assessee as he has special knowledge, and he is privy to the facts of the company and only he has opted for this method. Hence. he has to satisfy about the correctness of the projections, Discounting factor and Terminal value etc. with the help of Empirical data or industry norm if any and/or Scientific Data, Scientific Method, scientific study and applicable Guidelines regarding DCF Method of Valation."

5.4.5. Further, Commenting on the conclusion arrived at by the A.O. in Para 12 & 13 of the Assessment Order the Ld AR submitted that the same being based on misplaced understanding of the provisions of section 56(2)(viib) and Rule 11 UA, specially the Rule 11UA(1)(c)(c) and Rule 11UA(2)(a), just speaks of the ignorance or the pre-determined state of mind of the Officer to make addition. Referring to the provisions of Explanation to section 56(2)(viib) of the Act and the provisions of Rule 11UA(1)(c)(c) and Rule 11UA(2) it was submitted that the Legislature has provided different methods for computing fair market value' of 'unquoted equity shares' and unquoted shares other than the equity shares' and so far Appellant's case is concerned, the fair market value' of 'CCPS' having been estimated in accordance with the provisions of Rule 11UA(1)(c)(c), A.O. had no jurisdiction/power to object to the same and substitute his valuation. It was further

*submitted that as far as Rule 11UA (2) is concerned, firstly, this Rule is for computing the fair market value' of 'unquoted equity shares' and secondly, Rule has given option to the Assessee to compute the value in accordance with Rule 11UA(2)(a) or Rule 11UA(2)(b) and for that purpose the assessee has to be allowed an opportunity to select its option, which was missing in this case. According to him **A.O. did not have jurisdiction/power either to reject the Valuation Report or to substitute his own value computed under Rule11UA(2)(a) or 11UA(2)(b) and therefore the addition under dispute/ appeal may kindly be deleted.***

5.4.6. In the interest of substantial interest, the Appellant was directed to submit its reply to the show cause notice issued by the AO on 03.12.2018 and some other issues. On 9.07.2020 Appellant's counsel Advocate Sh. I.S. Verma along with Sh. D.R. Rajan, C.A. cum General Manager of the appellant group of company attended the hearing and submitted written reply which has been reproduced in this order supra in para 4:2 pages 24 to 31 of this order.

5.4.7. Case was discussed with the ARs and written replies have also been perused. In view of the provisions of 250(4), which provide that before disposing of the appeal, the CIT(A) may make such further inquiry as he thinks fit or may direct the A.O. to make further inquiry, and the unprecedented Covid-19 restrictions it was thought fit to verify the Appellant's reply to show cause notice vis-à-vis to the allegations/ shortcomings/defects etc pointed and relied upon by the A.O. to reject the valuation report and consequently the F.M.V. of the CCPS.

5.4.8. After having considered the facts on records, contents of show cause notice, AO's case, Appellant's reply, provisions of section 56(2)(viib) read with Explanation thereto and the Rule 11UA (1)(c)(c) and Rule 11UA(2)(a)/ 11UA(2)(b), I find force in the submissions of the appellant. Had the A.O. considered the appellant's various replies and the C.A's reply, which were filed before issuing show cause notice, in right perspective, there could have been no reason for issuing the Show-Cause Notice, what to say of the rejection of the Valuation Report/F.M.V. A.O's approach to the whole issue seems to be the provisions of section 56(2)(viib) and the quantum of premium, which itself cannot be sustained.

5.4.9. I have also found that the Appellant's reply against show cause notice and the C.A's reply filed in response to notice u/s.133(6) satisfy all the objections, on the basis of which the A.O. rejected the Valuation report and made the addition. In the totality of the facts and circumstances and the provisions of Law addition of the premium received on issuance of the CCPS, which otherwise was from well explained sources, was not justified and the same deserves to be deleted.

5.4.10. Even otherwise also, since each CCPS was to be converted after a period of 18 yrs, compulsorily, in 100 shares of face value of Rs. 10/- each, the value of Rs. 1000/- of each CCPS as on the date of allotment could not be said to be unreasonable or in excess of the F.M.V. on that date. Therefore, appellant's case is out of the provisions of section 56(2)(viib). The addition under appeal is therefore, directed to be deleted on this count also. Therefore, the addition of Rs.79,19,01,000/- u/s 56(2)(viib) is hereby deleted. Accordingly, grounds of appeals no. 2 to 6 on this addition are allowed."

3. Aggrieved by the order of the Ld.CIT(A), the Revenue is in appeal before us with following grounds of appeal:

- “1. The Ld.CIT(A) has erred in law and on facts in deleting the addition of Rs 79, 19,01,000/- U/s 56(2) (viib) of the IT Act
2. The Ld CIT(A) failed to appreciate that to arrive at fair value of the unquoted non-cumulative compulsory convertible preference shares, the Valuer has taken future cash flows as certified by Management without verifying the projections and assumptions adopted by the management.
 - 2.1.The CIT(A) failed to appreciate that the valuation has been determined based on unverified exorbitant cash flow given by management resulting in inflated value of shares @ Rs. 990/- per share as evident from the Income tax returns filed by the assessee in respect of F.Y.2016-17 & F.Y.2017-18 declaring huge losses of Rs 1,20,56,06,279/- and Rs 61,02,54,218/- respectively
 - 2.2The CIT(A) failed to appreciate that the valuer had not taken into consideration the financials of the. company on 19.11.2018 i.e date of issuance of shares while determining the value of share.
3. The CIT(A) failed to appreciate that as per the Explanation a(ii) to Section 56(2) (viib), the assessee was bound to substantiate the valuation of shares 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.
4. The CIT(A) failed to provide any opportunity to the Assessing Officer to reconsider the evidences based on which such relief was granted to the assessee

5. *The CIT(A) failed to appreciate that during the course of assessment proceeding, the assessee had not given any specific response to the show cause issued by the Assessing Officer and Sub-rule (3) of Rule 46A interdicts the CIT (A) from taking into account any evidence produced for the first time before him unless the Assessing Officer has had a reasonable opportunity of examining the evidence and rebut the same.*
6. *Whether the order of the CIT(A) deleting the addition made by the Assessing Officer is perverse as it has relied on the wrong fact that the assessee had submitted all the relevant material before issuance of the show cause notice (SCN) and it was not required to respond further to the SCN issued by the Assessing Officer.*
7. *The appellant craves leave to amend alter any ground or add a new ground, which may be necessary."*

On the grounds of appeal

4. The Ld.Departmental Representative (DR) explained the issue with reference to the order of AO. He specifically pointed out that the net value of share is negative on 31st March-2015 and the valuation is based on management's projected financials which is not independently verified. He also pointed out that the projected financials are far from reality as observed by the AO. The Ld.DR also placed reliance on Decision of **Delhi Tribunal in case of Agro Portfolio (P) Ltd. Vs. Income Tax Officer, Ward 1(4), New Delhi [2018] 94 taxmann.com 112 (Delhi -Trib.)** where the AO rejected the valuation report and independently determined FMV of the shares as the Merchant banker had solely relied upon the assumed data without independent verification or truthfulness and completeness of information.

5. The Ld.Authorised Representative (AR) of the assessee stated that the assessee is a wholly owned subsidiary of holding company Hindustan Cleanenergy Ltd. to whom 7,99,900 Compulsorily Convertible Preference

Shares (CCPS) of face value of Rs.10/- each are issued at a premium of Rs.990/- per share. He further stated that as per the terms of issue of CCPS, these shares will be compulsorily converted into equity shares within a period of 18 years from the date of issue at the option of the company or shareholder in the ratio of 100:1 meaning 100 equity shares in lieu of 1 CCPS or as may be determined by the company at the time before such conversion.

5.1. The Ld.AR further stated that the Valuer was issued notice u/s 133(6) of the Act by the AO calling for the information and the Valuer submitted all the details called for. He also stated that the Valuer reviewed the financial projections and the basis on which these were prepared and the Valuer, in his reply to AO, stated that the assumptions were validated by an independent technical consultant who prepared the detailed project report. Therefore, the validation of projections was done by an independent expert. The Ld.AR argued that the legislative intent of section 56(2)(viib) of the Act is to deter the generation and use of unaccounted money done through subscription of shares of a closely held company, at a value which is higher than the Fair Market Value (FMV) of shares of such company and in the present case where holding company has infused capital by way of hybrid instrument of CCPS therefore the AO's addition is not in line with the legislative intent. He stated that the Ld.CIT(A) has dealt with this issue in detail and placed reliance on following judicial pronouncements:

1. ITO, Ward - 24(1), New Delhi Vs. Solitaire BTN Solar Pvt. Ltd (ITA No. 1416/DEL/2020 dated 12-6-2024).
2. ACIT, Circle -7(2), New Delhi Vs. Dhruv Milose Pvt. Ltd. (ITA No. 8431/DEL/2019 dated 8-2-2024).
3. Rugby Regency (P.) Ltd. Vs. Additional Commissioner of Income Tax (ITA No.653/DEL/2019 dated 25-1-2024).

6. We have heard the rival contentions and perused the material available on records. We noted that the assessee as per its submission dated 09-07-2020 before the Ld.CIT(A) provided information which was already available with the AO. We also noted that the Ld.DR also has not argued on the Ground Nos. 4, 5, and 6, therefore they are dismissed.

6.1. Relating to Ground Nos.1 to 3, we noted that the Ld.CIT(A) has dealt with the same in detail. The Ld.CIT(A) supported the valuation process, asserting that it was conducted in accordance with the legal provisions and CBDT/Legislature rules. The Ld.CIT(A) has criticized the AO for not having the power to reject the valuation or substitute his own method. The fair market value (FMV) determined by the Valuer is defended by the Ld.CIT(A) as neither exaggerated nor incorrect. The Ld.CIT(A) emphasized that the AO cannot arbitrarily reject a Valuation Report that complies with established legal guidelines. The FMV determined by the Valuer is upheld, provided it follows the prescribed rules. The Ld.CIT(A) has also justified the method adopted for valuing CCPS and the disclaimers by the Valuer. The Ld.CIT(A) has made a reference to a previous appellate order in favour of

the assessee, supporting the Valuer's methodology and disclaimers. The Ld.CIT(A) has cited the ITAT Bangalore Bench's decision in the case of Innovit Payment Solutions Pvt. Ltd. to reinforce the process and principles for scrutinizing valuation reports. The Ld.CIT(A) reinforced that Valuers must provide disclaimers due to the inherent uncertainties in valuations. The decision cited by the Ld.CIT(A) underscores that the AO can scrutinize, but not arbitrarily reject a valuation without proper reasons and adherence to the DCF method, which cannot be changed by the AO. The CIT(A) found fault with the AO's interpretation of Section 56(2)(viib) and Rule 11UA. The Ld.CIT(A) deemed that the AO's rejection of the valuation report beyond his jurisdiction, especially when the valuation is done as per Rule 11UA(1)(c)(c). Thus, the Ld.CIT(A)'s decision systematically dissects the AO's actions, emphasizing adherence to legal procedures and the importance of a fair valuation process.

6.2. We have reviewed the judicial pronouncements relied on by the Ld.DR. The decision of **Delhi Bench of ITAT in the case of Agro Portfolio (P.) Ltd. (supra)** is not applicable in the present case as shares were allotted to third party and the merchant banker solely relied upon the information and financial data provided by the company without independent verification. As against in the present case the shares are allotted to the holding company by wholly owned subsidiary and the financial projections were prepared and validated by independent technical expert.

6.3. The judicial precedents relied on by the Ld.AR are also reviewed. In case of **Dhruv Milkose Pvt. Ltd.(supra)**, the Tribunal decided that the AO cannot change the method of valuation chosen by the assessee if it complies

with the prescribed law and rules. In case of **Solitaire BTN Solar Pvt. Ltd.(supra)**, the Tribunal emphasized that transactions between holding and subsidiary companies at a premium do not attract Section 56(2)(viib) of the Act as the legislative intent is not to tax such transactions. In case of **Rugby Regency (P.) Ltd.(supra)**, the Tribunal confirmed that the AO must scrutinize the valuation based on the facts available at the time of valuation and cannot rely on subsequent financial performance.

6.4. Based on the facts and judicial pronouncements, we conclude that the DCF method adopted by the assessee for valuing the CCPS is legitimate and in accordance with Rule 11UA. The AO cannot reject the method chosen by the assessee if it is prescribed by law.

6.5. The AO's reliance on the company's subsequent financial losses to question the valuation is misplaced. The projections must be assessed based on the facts and data available at the time of valuation, not on future outcomes, as held in various judicial pronouncements. The issuance of CCPS to the holding company does not align with the legislative intent of Section 56(2)(viib) of the Act to prevent the generation and use of unaccounted money. The transaction between a wholly owned subsidiary and its holding company does not create any unaccounted income or inflated share value for tax evasion purposes unless it is specifically proved. The Ld.CIT(A) correctly applied the provisions of law and judicial precedents in deleting the addition made by the AO. The valuation of shares based on the DCF method is valid, and the AO's objections lack merit. The order of the Ld.CIT(A) is upheld. The addition of Rs.79,19,01,000/- under Section 56(2)(viib) of the Act is hereby deleted.

7. In the result, the appeal filed by the Revenue is dismissed.

Order pronounced in the Open Court on 25 July, 2024 at Ahmedabad.

Sd/-
(SIDDHARTHA NAUTIYAL)
JUDICIAL MEMBER

Sd/-
(MAKARAND V. MAHADEOKAR)
ACCOUNTANT MEMBER

अहमदाबाद/Ahmedabad, दिनांक/Dated 25/07/2024

टी.सी.नायर, व.नि.स./T.C. NAIR, Sr. PS

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

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त (अपील)/ The CIT(A)-32, New Delhi
5. विभागीय प्रतिनिधि,आयकर अपीलीय अधिकरण ,राजोकट/DR,ITAT, Ahmedabad,
6. गार्ड फाईल /Guard file.

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आयकर अपीलीय अधिकरण, ITAT, Ahmedabad