IN THE INCOME TAX APPELLATE TRIBUNAL
“C” BENCH, AHMEDABAD

BEFORE SHRI T.R. SENTHIL KUMAR, JUDICIAL MEMBER &
SHRI NARENDRA PRASAD SINHA, ACCOUNTANT MEMBER

आयकर अपील सं./I.T.A. No. 2263/Ahd/2017
(**निर्धारण वर्ष /** Assessment Year : 2013-14)

Parasmani Gems Pvt. Ltd. 2, Supan Complex, Nr. Dharnidhar Derasar, Paldi, Ahmedabad, Gujarat - 380006	**बनाम/** Vs.	**The D.C.I.T.** Circle 3(1)(1), Ahmedabad
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AADCP6337M		
(Appellant)	..	**(Respondent)**

अपीलार्थी ओर से /**Appellant by :**	Shri Mehul K Patel, AR
प्रत्यर्थी की ओर से/**Respondent by :**	Shri Rignesh Das, Sr. DR

Date of Hearing	23/10/2024
Date of Pronouncement	21/11/2024

O R D E R

PER SHRI NARENDRA PRASAD SINHA, AM:

This appeal is filed by the assessee against the order of the Commissioner of Income Tax (Appeals)-9, Ahmedabad, (in short ‘the CIT(A)’), dated 02.08.2017 for the A.Y. 2013-14.

2. The brief facts of the case are that the assessee company is engaged in the business of manufacturing and trading of gold and diamond jewellery. The return of income for A.Y. 2013-14 was filed on 28.09.2013 declaring total income at Rs.51,74,100/-. The case was selected for scrutiny under CASS. In the course of assessment, the AO found that the assessee had introduced funds by way of issue of share capital. It was noticed that shares were

allotted on 03.11.2012 and on 26.03.2013 to three persons namely, Daxesh Manharlal Soni, Kunal Manharlal Soni & Nirav Manharlal Soni. The AO found that on the face value of share of Rs.10/- allotted on 03.11.2012 premium of Rs.90 per share was charged, whereas the shares allotted on 26.03.2013 were issued at a premium of Rs.31.67 per share only. The AO, therefore, required the assessee to justify the consideration for shares issued on 03.11.2012 in accordance with the provisions of Section 56(2)(viib) of the Income Tax Act, 1961 (in short 'the Act'). It was explained that the shares allotted on 03.11.2012 were on the basis of fair market value (FMV) of the shares as determined under Discounted Cash Flow (DCF) method, in support of which a report of the Accountant was filed. However, the AO was not satisfied with the working of the FMV of the shares. He, therefore, rejected the DCF method of valuation adopted by the assessee and worked out the value of the shares as per Net Asset Value (NAV) method, which worked out to Rs.34.55 share only. Accordingly, the AO held that the premium charged to the extent of Rs.55.45 (90-34.55) per share was excessive and accordingly the share premium of Rs.94,26,500/- was added u/s.56(2)(viib) of the Act. Subsequently, the order was rectified by the AO u/s.154 of the Act for the reason that the working of disallowance of Rs.94,26,500/- was not correct. Vide rectification order, the disallowance u/s.56(2)(viib) of the Act was restricted to Rs.27,72,500/- only.

3. Aggrieved with the order of the AO, the assessee had filed an appeal before the First Appellate Authority, which has been

decided vide the impugned order and the appeal of the assessee was dismissed.

4. Now, the assessee is in second appeal before us. The following grounds of appeal have been taken in this appeal:

> *"(1) That on facts and in law, the learned CIT(A) has grievously erred in confirming the addition of Rs.27, 72,500/- made u/s 56(2)(viib) of the Act.*
>
> *(2) That on facts, evidence on record, and in law, the learned CIT (A) ought to have accepted the valuation done by appellant's C.A. and ought to have held that the provisions of section 56(2)(viib) of the Act are not applicable and the entire addition ought to have been deleted, as prayed for.*
>
> *(3) That on facts Commissioner of and in law the learned Commissioner of Income Tax (Appeals) has grievously erred in confirming the levy of interest u/s 234A, 234B, and 234C of the Act.*
>
> *(4) The appellant craves leave to add, alter, amend any ground of appeal."*

5. Shri Mehul K. Patel, Ld. Counsel appearing for the assessee submitted at the outset that there was no fresh introduction of capital during the year. He explained that the assessee had taken loans from the three shareholders, which was converted into share capital during the year and thus, no fresh consideration towards share was received during the year. He relied upon the decision of *ITAT, Chandigarh in case of ACIT vs. I.A. Hydro Energy Pvt. Ltd. in ITA No.548/CHD/2022, dated 11.10.2023* and submitted that when no amount was received during the year towards share capital, the applicability of Section 56(2)(viib) of the Act was invalid. He further submitted that *this decision of the ITAT, Chandigarh was confirmed* by *Hon'ble High Court of Himachal Pradesh in ITA No.4 of 2024 dated 31.05.2024.*

6. The Ld. AR further explained that the provision of Section 56(2)(viib) of the Act was introduced by the Finance Act, 2012 w.e.f. 01.04.2013. However, Rule 11UA for determining the FMV of the shares was introduced only on 29.11.2012. Thus, there was no prescribed method for determining the FMV of unquoted equity shares for the purpose of Section 56(2)(viib) of the Act for the period from 01.04.2012 to 28.11.2012. Therefore, any allotment of unquoted shares during this period was outside the purview of Rule 11UA(2) as there was no prescribed method subsisting during this period. He, therefore, submitted that during the period from 01.04.2012 to 28.11.2012, the shares could have been allotted without attracting the provision of Section 56(2)(viib) of the Act as the machinery provision to work out the disallowance fails in the absence of any prescribed method of determining FMV under the Rules. In the alternative, the Ld. AR contended that the allotment of shares was done on the basis of DCF method in support of which certificate of the Accountant was filed by the assessee and the AO was not correct in rejecting the DCF method and adopting NAV method for determining the FMV. He submitted that under Rules, an option was given to the assessee to adopt either NAV or DCF method for determining the FMV of the shares.

7. Per contra, Shri Rignesh Das, the Ld. CIT. DR submitted that the provision of Section 56(2)(viib) of the Act prescribes "any consideration for issue of shares" and that the word "consideration" had a much wider implication. In this regard, he relied upon the decision of *ITAT Mumbai in the case of Keep Learning Resources Pvt. Ltd. vs. ITO in ITA No.1692/Mum/2023,*

dated 31.08.2023, wherein identical issue of conversion of loan advanced in the past into equity shares with share premium was involved and the ITAT had held that the transaction would be covered by the provision under Section 56(2)(viib) of the Act. The Ld. Sr. DR also relied upon the decision of *ITAT, Kolkata Tribunal in case of Milk Mantra Dairy (P.) Ltd. vs. DCIT, [2022] 140 taxmann.com 163 (Kolkata-Trib.).* The Ld. Sr. DR further submitted that assessee had issued shares on two occasions i.e. on 03.11.2012 and on 26.03.2013, both during the same financial year. While shares on 03.11.2012 were issued at premium of Rs.90/- per share, the shares allotted on 26.03.2013 were issued at premium of Rs.31.67 per share only. The Ld. Sr. DR submitted that the assessee had not explained the huge difference in the FMV of the shares in the two allocations made during the same financial year. The Ld. Sr. DR assailed the contention of the assessee that the premium of Rs.90 in the first allocation was on the basis of FMV as per DCF method as determined by the Accountant. He submitted that the premium of Rs.31.67 charged by the assessee in the second allotment on 26.03.2013 itself proved that the premium charged earlier in the first allocation was not as per correct FMV. The Ld. Sr. DR, therefore, strongly supported the order of the AO & the Ld. CIT(A).

8. We have carefully considered the rival submissions. The first contention of the assessee is that that there was no fresh inflow of funds in respect of allotment of shares and that it was only an accounting entry for conversion of loans into share capital. Therefore, the provision to Section 56(2)(viib) of the Act was not at all attracted. The assessee has relied upon the decision

of coordinate bench of ITAT, Chandigarh, in the case of *I.A. Hydro Energy Pvt. Ltd.(supra)* in this regard, wherein the following findings were recorded:

> *"30. It is, thus, seen that the ld. CIT(A) has observed that it is undisputed fact that the appellant did not receive any consideration for allotment of shares in the previous year relevant to current assessment year. The AO has not discussed this fact neither countered this contention of the appellant. It is a clear fact that the erstwhile partners of the erstwhile Firm (converted into appellant company) had given loans to the said firm which was converted into share capital of those partners becoming the shareholders. The AO has mentioned in the assessment order that the loans outstanding as on 01.04.2017 were converted into share capital. The shares were issued at Rs.10 per share face value and premium of Rs.90 per share. After plain reading of S.56(2)(viib), there is no doubt that this provisions is applicable to the considerations received in the previous year under consideration for taxing the excess premium charged over and above fair market value of shares determined as per prescribed method under Rule 11UA. In the current facts of the case, the appellant did not receive any consideration in the current assessment year and the outstanding loans of existing partners of erstwhile firm was converted into the shares of the appellant company. Thus, prima facie, there is no justification for the AO to apply Section 56(2)(viib) of the Act in the appellant's case. The said consideration in the form of unsecured loans were received from the partner of the erstwhile firm in the year 2010 (as evidenced from loan agreement) and the AO could not bring out any material facts to show that such conversion of loans to equity shares was a ploy to defraud revenue of the tax on such transaction. In fact, the loans received in earlier years also got tested through scrutiny assessments completed for assessment year 2013-14, 2014-15, 2016-17 and 2017-18 in the case of the erstwhile firm. Thus, it can be concluded that the AO has not made out any case that the share conversion by the appellant led to defrauding revenue of its due taxes. Thus, firstly, the amount is not received in the relevant previous year makes the applicability of S.56(2)(viib) invalid in the case of the appellant and secondly, the legislative intent to arrest abuse of tax laws to defraud revenue is also not available in the current facts of the case as the receipt of loans in the earlier years were from the existing partners of the erstwhile firm which got duly verified in the scrutiny of various assessment years after loans receipt."*

9. The coordinate bench of Chandigarh Tribunal, in that case, had held that in the case of conversion of loan into share capital, no consideration was received. Further that such conversion of

loan into share capital did not lead to defrauding the Revenue of its due taxes. The Ld. AR has submitted that this decision of Chandigarh Bench of ITAT was upheld by Hon'ble Himachal Pradesh High Court and, therefore, the ratio of this decision should be applied in the present case. We have carefully considered the submission of the Ld. Counsel. It is found that the Hon'ble High Court, on the basis of the finding recorded by the ITAT had held that no substantial question of law was involved. The issue of whether provision of section 56(2)(viib) of the Act was applicable in the case of conversion of loan into share capital, was not independently examined by Their Lordships. The relevant part of the order of the Hon'ble High Court is reproduced below:

> *"18. We are of the opinion that the orders passed by the Income Tax Appellate Tribunal as well as the CIT(Appeals), are fairly comprehensive. Both of them have concurrently found that no consideration was received by the assessee-firm for allotment of the shares, therefore Section 56(2)(viib) of the Act would not apply, and that it would have applied only if consideration was received for such a transaction.*
>
> *19. Also, both the Tribunal and the CIT(Appeals) have held that the Assessing Officer had no jurisdiction to substitute the NAV method of assessing the valuation of shares, once the assessee had exercised option of a DCF valuation method as per Rule 11UA(2) of the Income Tax Rules.*
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> *20. We agree with the reasoning adopted by the CIT(Appeals) confirmed by the ITAT on all aspects and find that no substantial questions of law arise in this appeal for consideration by this Court.*
>
> *21. Accordingly, the appeal fails and is dismissed."*

10. The assessee has contended that the decision of Hon'ble Himachal Pradesh High Court in the case of *I.A. Hydro Energy Pvt. Ltd. (supra)* should be followed to maintain the judicial discipline. While the views expressed by even non-jurisdictional High Court does deserve utmost respect and reverence, that position is still a step

below the unquestionable binding force of law. A mere declaration that no substantial question of law was involved, on the basis of findings of the lower authorities, can't be considered as a binding precedent. In that case, the Hon'ble High Court had considered the findings of the Tribunal on the issue of conversion of loan into share capital and the fact that the AO had no jurisdiction to substitute NAV method of valuation of shares when the assessee had opted DCF method of valuation. In the present case, however, the assessee has not explained as to why the first allotment of shares was done at premium of Rs.90/- per share whereas the second subsequent allotment, after a gap of 5 months, was made at a premium of Rs.31.80 per share only. Thus, the facts of the present case are found to be totally different and, therefore, the ratio of the decision of Hon'ble Himachal Pradesh High Court cannot be imported to the peculiar facts of the present case. Further, the Hon'ble non-jurisdictional High Court judgment, in any event, do not constitute unquestionably binding judicial precedent.

11. The provision of section 56(2)(viib) of the Act was introduced by the Finance Act, 2012 w.e.f. 1-4-2013 and is applicable to A.Y. 2013-14. The applicable law as enunciated u/s. 56(2)(*viib*) of the Act, is reproduced for ease of reference:

> *56(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head "Income from other sources", namely: —*
>
> …….
>
> ***(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:***

Provided that this clause shall not apply where the consideration for issue of shares is received—
(i) by a venture capital undertaking from a venture capital company or a venture capital fund or a specified fund; or
(ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf:
…….
[Emphasis supplied]

12. The Memorandum for introduction of this provision explained the intention of the legislature as under:

SHARE PREMIUM IN EXCESS OF THE FAIR MARKET VALUE TO BE TREATED AS INCOME

Section 56(2) provides for the specific category of incomes that shall be chargeable to income-tax under the head "Income from other sources".

It is proposed to insert a new clause in section 56(2). The new clause will apply 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. In such a case if the consideration received for issue of shares exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income-tax under the head "Income from other sources". However, this provision shall not apply where the consideration for issue of shares is received by a venture capital undertaking from a venture capital company or a venture capital fund.

Further, it is also proposed to provide the company an opportunity to substantiate its claim regarding the fair market value. Accordingly, it is proposed that the fair market value of the shares shall be the higher of the value—

(i) as may be determined in accordance with the 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 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.

This amendment will take effect from 1st April, 2013 and will, accordingly, apply in relation to the assessment year 2013-14 and subsequent assessment years.

13. The provision of the Act as well as the Memorandum for introduction of this provision made it explicit that if the consideration was received for issue of shares that exceeded the

fair value of such shares, then the consideration received for such shares, as exceeding the fair market value of the shares, shall be chargeable to tax under the head income from other sources. There is no stipulation in the section that it will be applicable only in the case of receipt of any 'amount' or 'money' on account of share application money. Rather the word used in the section is 'any consideration for issue of shares' which has a very wide implication. The ITAT, Kolkata in the case of *Milk Mantra Dairy (P.) Ltd. (supra)* had considered the word 'consideration' in this context and given the following findings:

> ***12.3*** *Before delving into whether conversion entails any consideration, we would ponder upon the term "consideration", which in our view is a term of wider import when compared with words "amounts" or "money". Receipt of money is one of the several modes for having a consideration in a transaction. Consideration can partake many forms viz. tangible or intangible, pecuniary or non-pecuniary, direct or indirect. Section 56(2)(viib) contains the words "receives any consideration" which encompasses consideration in all forms and not limited to only receipt of money. In this backdrop let us understand what the assessee receives as consideration on the conversion of a debt security of CCDs into equity shares which subsequently forms part of the capital base of the assessee. Not listing these as an exhaustive list but some of the "considerations" which the assessee "receives" on the conversion of its CCDs into equity shares, are enumerated as under:—*
>
> *(i) The debt obligation on the assessee to repay is extinguished.*
>
> *(ii) The charge created on the assets/properties of the assessee to secure the debt obligation is released.*
>
> *(iii) The cost of servicing the debt obligation by paying periodic interest is mitigated.*
>
> *(iv) The capital based in the form of own fund gets widened to leverage on the capital/stock markets.*
>
> *(v) The debt-equity ratio becomes favourable to various stakeholders of the assessee making it more investor attractive/lucrative.*
>
> *(vi) The risk of getting into the claim of insolvency resolution from the debt creditors in case of default in servicing their debt obligation is mitigated, so on and so forth…*
>
> *12.4 Further, from the extracts reproduced in para 11 above from the Investment Agreement placed on record, the terms and conditions, warranties and other covenants relating to issuance of CCDs and their subsequent conversion into equity shares evidently records and*

corroborates few of the considerations listed above relating to discharge of obligation, release of encumbrance, interest obligation, pari passu ranking of rights of equity shareholders, etc. Thus, when looked from these aspects, section 56(2)(viib) of the Act envisages a much wider outlook to the "receipt of any consideration" which cannot be limited to the receipt of money only. ...

14. The ITAT, Mumbai in the case of *Keep Learning Resources Pvt. Ltd. (supra)* had categorically held that the conversion of loan amount into equity shares will not exonerate the assessee from application of provision of section 56(2)(viib) of the Act. Keeping in view, the language of section which uses the term 'consideration' which is of wider import when compared with word 'amounts', we are inclined to agree with the decision of ITAT, Mumbai and ITAT, Kolkata on the issue. Therefore, the contention of the assessee that provision of section 56(2)(viib) of the Act will not be attracted in the case of conversion of loan amount into share capital is rejected. In our considered opinion the provisions of Section 56(2)(viib) of the Act do apply in the present case of conversion of loan into share capital and the view adopted by the ITAT Chandigarh Bench will make the provisions of section 56(2)(viib) otiose for all such transactions of conversion of securities.

15. The second contention of the assessee is that there was no prescribed method of valuation of shares during the year from 01.04.2012 to 28.11.2012 and, therefore, the machinery provision had failed. It will be relevant here to reproduce the Explanation to Section 56(2)(viib) of the Act, which is as under:

Explanation: - For the purposes of this clause,—
(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;*

16. The Explanation to this section had given two alternatives for the FMV of the shares - the first was as determined in accordance with such method as prescribed and the second was the value as substantiated by the company based on the value of different assets on the date of issue of shares. The contention of the assessee is that the method prescribed to determine the FMV of shares was notified only on 29.11.2012 i.e. after the date of issue of shares by the assessee company on 03.11.2012. As rightly pointed out, the Rule 11UA was notified w.e.f. 29.11.2012 and, therefore, there was no prescribed method to determine the FMV of shares on the date when the shares were first allotted by the assessee on 03.11.2012. Nevertheless, the other alternative of the determination of FMV of shares on the basis of value of different assets was available. Therefore, it cannot be held that the machinery provision for determining the FMV of the shares was not available on the date of issue of shares by the assessee company. As per the second option prescribed under Explanation, the assessee was required to substantiate the value adopted for issue of share on the basis of value of its assets including intangible assets. Therefore, the machinery provision for working out the FMV of the shares was indeed available on the day when the shares were first allotted by the assessee on 03.11.2012.

17. The contention of the assessee is that it had rightly adopted the value as per DCF method as determined by the Accountant. A copy of this valuation report was filed and the Ld. CIT(A) has given the finding that this valuation was done by the Accountant much later on 07.12.2015, whereas the shares were allotted on 03.11.2012. Since, the assessee had filed the valuation report of a much later date, the Revenue had rightly concluded that this valuation did not reflect the real and correct value but was only an afterthought to justify the valuation as adopted at the time of issue of first tranche of shares. It is true that the assessee has an option to adopt DCF or NAV method to determine the FMV of the shares. Whatever method is chosen by the assessee the same is required to be consistently applied. The basic question raised by the Revenue is that if the valuation of the share was so high to justify premium of Rs.90/- on 03.11.2012, why premium of Rs.31.67 per share only was charged in the subsequent allotment of shares on 26.03.2013 and this aspect has not been explained by the assessee. There cannot be such a wide fluctuation in the value of shares within a period of less than 5 months and that too within the same financial year. In the absence of any explanation for charging premium of Rs.31.67 per share only in the subsequent allotment of shares on 26.03.2013, we are of the considered opinion that the Revenue had rightly made the disallowance of Rs.27,72,500/- u/s. 56(2)(viib) of the Act in respect of excess premium over and above FMV of the shares allotted on 03.11.2012.

18. In view of the above facts, we are of the view that the Ld. CIT(A) was justified in confirming the addition of Rs.27,72,500/-

made u/s. 56(2)(viib) of the Act in respect of excess share premium. We, therefore, uphold the order passed by the Ld. CIT(A).

19. In the result, the appeal filed by the assessee is dismissed.

This Order pronounced on 21/11/2024

Sd/-	Sd/-
(T.R. SENTHIL KUMAR)	(NARENDRA PRASAD SINHA)
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Ahmedabad; Dated 21/11/2024

S. K. SINHA *True Copy*

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)-
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, अहमदाबाद / DR, ITAT, Ahmedabad
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

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आयकर अपीलीय अधिकरण, अहमदाबाद / ITAT, Ahmedabad