

**IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH : BANGALORE**

**BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
AND
MS. MADHUMITA ROY, JUDICIAL MEMBER**

ITA No. 494/Bang/2023
Assessment Year : 2016-17

M/s. MobiCom Technologies Pvt. Ltd., 1/4, Cunningham Road, Bangalore North, Bangalore – 560 001. PAN: AAGCC0063N	Vs.	The Income Tax Officer, Ward – 4(1)(4), Bangalore.
APPELLANT		RESPONDENT

Assessee by	:	Shri Padam Chand Khincha, CA
Revenue by	:	Shri V. Parithivel, JCIT (DR)

Date of Hearing	:	07-09-2023
Date of Pronouncement	:	12-09-2023

ORDER

PER MADHUMITA ROY, JUDICIAL MEMBER

The instant appeal filed by the assessee is directed against the order dated 11.05.2023 passed by the National Faceless Appeal Centre (NFAC), Delhi arising out of the order dated 29.12.2018 passed by the ITO, Ward No. 4(1)(4), Bangalore u/s. 143(3) of the Income Tax Act, 1961 (hereinafter referred to as “the Act”) for A.Y. 2016-17 whereby and whereunder

the addition of Rs.1,04,50,000/- u/s. 56(2)(viib) of the Act made by the Ld.AO holding the share premium received by the appellant company is in excess of fair market value of the share has been confirmed.

2. The brief fact leading to the case is this that the appellant company engaged in providing software development services for computer of all kinds, peripherals, consumables and software, registered on 09.04.2015 filed its return of income on 23.09.2016 declaring loss of Rs.9,40,028/-. It is relevant to mention that the assessee company did not claim itself as a start-up as defined by DIPP, neither filed any certificate to prove that the company is registered as a start-up. During the course of scrutiny assessment, a notice u/s. 143(2) followed by notice u/s. 142(1) was issued to the assessee. It was revealed that the assessee credited a sum of Rs.1,14,95,000/- under security premium reserve account. It had allotted 1045 shares totaling value of Rs.10,45,000/- (Rs.1,000/- per share) and treated the balance of Rs.1,04,50,000/- as share premium. The equity shares of Rs.1,000/- each were issued at premium of Rs. 10,000/- each to one Shri Rathan Kumar. The valuation report of the accountant was also filed. It was found that the valuation of the shares were done on the books following DCF method forecasting the future growth which is a hypothetical estimation and not in accordance with Rule 11 UA of the IT Rules as of the opinion of the Assessing Officer.

3. During the course of scrutiny assessment, the valuer of the shares namely Shri K.R. Narasimha Murthy was summoned on 16.11.2018 in order to verify the basis and documents relied upon and strategy adopted to arrive the share premium at Rs.10,000/-. The Ld.AO did not accept the DCF method of valuation of the share for the following reasons as it appeared from the order passed by the Ld.AO:

"2.5. In this regard, it is pertinent to note the provisions of clause (viib) of Sub-section (2) of section 56 of the IT Act 1961, which stipulates that "where a company, not being a company in which the public are substantially interested, received 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', shall be chargeable to income-tax under the head "Income from Other Sources".

2.6. With respect to the Fair Market Value of the shares, the market value of shares is to be calculated either 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, licenses, franchises or any other business or commercial rights of similar nature or as per the provisions of Rule 11UA(2), which so ever is higher. Since the assessee has failed to substantiate the market value of shares, the provisions of Rule 11UA(2) are attracted which reads as under:-

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

the fair market value of unquoted equity

$$1. \text{ Shares} = \frac{(A-L) \times (PV)}{(PE)}$$

where,

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 unamortized 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:-

1. the paid-up capital in respect of equity shares;
2. 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;
 1. reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
 1. 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;
 1. any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
 1. any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

P E = total amount of paid up equity share capital as shown in the balance sheet;

P V = the paid up value of such equity shares; or

(b) The fair market value of the unquoted equity shares determined by the Merchant banker or an accountant as per the Discounted Free Cash Flow method.

2.7. It may be noted that the Hon'ble Supreme Court in its decision in the *M/s. G L Sultania & Others . Vs. SEBI (Civil*

A No.1704 of 2006) dated 16/05/2007 has given the following finding in Para 32 of the order:

"These decisions clearly lay down the principle that valuation of shares is not only a question of fact but also raised technical & complex issues, which may be appropriately left to the wisdom of experts, having regard to the many imponderables which enter the process of valuation of shares. If the valuer adopts the methods of valuation prescribed, Or in the absence of any prescribed method, adopts any method of valuation. His valuation can not be assailed unless it is shown that the valuation was made on a fundamentally erroneous basis, or that a patent mistake had been committed. Or the valuer adopted a demonstrably wrong approach or a fundamental error going to the root of the matter."

In this case, the fundamentals of the Company adopted by the valuer is found to be highly inflated in comparison to the actual revenue in last 3 years. Hence, the value of the share adopted is highly inflated and it does not reflect the true state of affair of the company.

2.8. In a recent judgment dated 23/07/2018 in the case of M/s.Fidelity Business Services India (P) Ltd. .Vs. ACIT reported in 95 Taxmann.Com.253, the Hon'ble High Court of Karnataka has held that "the Tribunal was perfectly justified in directing an enquiry into the FMV of shares of the assessee Company which could have an implication of taxability U/ s.2(22)€ of the IT Act."

Hence, the Hon'ble High Court of Karnataka has agreed to held enquiry into the FMV of the Share and conclusion drawn by the valuer can not be a sacrosanct figure, which can not be examined by the AO.

2.9. Further, the Hon'ble ITAT, New Delhi in the case of M/s. Agro Portfolio Pvt. Ltd has held that in the absence of correctness of the result of DCF method, left no option to the AO but to reject the DCF method and to go by NAV method to determine the FMV of the shares.

2.10. In the present case, the valuation of shares is based on the Discounted cash flow method and on the projected financials, 2014-15, 2015-16, 2016-17, 2017-18, 2018-19 & 2019-20. The sales and PAT projections based on which

the share value has been arrived at is reproduced as under:-

"ANNEXURE-I

Convertible after 2019-2020

Existing equity shares : 300

No. of Preference shares : 1045

Preference shares to be converted to Equity Shares : for 1

Preference shares

12 Equity Shares

<i>Years</i>	<i>15-16</i>	<i>16-17</i>	<i>17-18</i>	<i>18-19</i>	<i>19-20</i>
<i>Cash Flows</i>					
<i>Net Profits</i>	<i>(9,40,027)</i>	<i>25,99,447</i>	<i>38,25,408</i>	<i>56,21,374</i>	<i>91,19,017</i>
<i>Depreciation</i>	<i>1,37,632</i>	<i>4,50,000</i>	<i>5,40,000</i>	<i>6,48,000</i>	<i>7,77,600</i>
<i>Cash Flow For Year</i>	<i>(8,02,395)</i>	<i>30,49,447</i>	<i>43,65,408</i>	<i>62,69,374</i>	<i>98,96,617</i>
<i>Discounting rate</i>					
<i>Risk free rate 15-16</i>	<i>7.75</i>	<i>7.75</i>	<i>7.75</i>	<i>7.75</i>	<i>7.75</i>
<i>Risk Premium</i>	<i>5.26</i>	<i>5.26</i>	<i>5.26</i>	<i>5.26</i>	<i>5.26</i>
<i>Discount Rate</i>	<i>11.14</i>	<i>11.14</i>	<i>11.14</i>	<i>11.14</i>	<i>11.14</i>
<i>Discount factor</i>	<i>1.00</i>	<i>0.90</i>	<i>0.81</i>	<i>0.73</i>	<i>0.66</i>
<i>Discounted Cash Flows</i>	<i>(8,02,395)</i>	<i>27,43,771</i>	<i>35,34,096</i>	<i>45,66,719</i>	<i>64,86,250</i>

<i>No. of shares after conversion</i>	<i>12.840</i>
<i>Particulars</i>	<i>Amount (Rs.)</i>
<i>Cash Profit in 2019-20</i>	<i>98,96,617</i>
<i>Perpetuity Cash Flow After 5 years</i>	<i>19,04,25,736</i>
<i>Discounted Value of Perpetual Cash Flow</i>	<i>12,48,05,166</i>

<i>SUM of Discounted Cash Flows</i>	<i>1,65,28,441</i>
<i>Present Value of Business</i>	<i>14,13,33,606</i>
<i>Perpetuity value of share</i>	<i>11,007</i>

*Terminal Cashflow (Net Profit after tax ± Depreciation)
*Growth
Cost of Equity — Growth rate*

2.11. The valuation is based on the perpetuity value of PBDIT of the year 2019-20 of Rs.91,19,017/-. On an analysis of the Table in Annexure-1 above, it is observed that the projections and the actual results achieved by the company based on the returns filed, there is substantial variance in the projected sales and PAT for the years Assessment Years 2016-17, 2017-18 and 2018-19. If the sales/revenue have not been achieved/or commenced in the present case as projected in the initial years, then the chances of increase in sales for the years 2017-18, 2018-19 and 2019-20 as given in the tables above is also without any basis. Further, it is noticed that there is no advance tax payment made during the current financial year also, it shows that there is no achievement, compared to figures adopted in the DCF method.”

4. According to him the price of the share exceeds the fair market value. He further relies on section 56(2)(viib) wherein the fair market value of the shares shall be the value as may be substantiated by the assessee to the satisfaction of the Ld.AO based on the value, on the date of issue of shares of its assets including intangible assets being good will, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature whichever is higher. Infact, he relies upon Rule 11 UA of the Rules which determines the fair market value of the unquoted equity shares wherein two methods has been

prescribed in order to determine the said fair market value of unquoted equity shares. According to the Ld.AO, the assessee received share premium on issue of preference shares and therefore the method adopted by the assessee in determining the fair market value of the equity share will not be applicable to determine the FMV of preference shares. The DCF method adopted by the assessee is, thus, not found acceptable. As he relies upon the Section 56(2)(viib) and in order to satisfy the same as the value of assets including intangible assets being good will, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature has not been provided by the assessee, the determination of the FMV of the preference share on the basis of the explanation rendered by the assessee was not found to be acceptable and therefore, the face value of the preference share ought to have been taken as the value of the share at which the appellant company should have received the preference share capital including the premium as of the opinion of the Ld.AO. According to him, only the face value of the preference share at Rs.1000/- per share should have been received by the company and the share premium to the tune of Rs.1,04,50,000/- from Mr. Rathan Kumar to whom the said preference share was allotted was found to be in excess of FMV of the share and thus added to the total income of the assessee, which was inturn, confirmed by the First Appellate Authority. Hence the instant appeal before us.

5. At the time of hearing the instant matter, the Ld.Sr. Counsel Shri Padam Chand Khincha submitted before us that the authorities below has failed to appreciate that the shares under consideration are preference shares and not equity shares. Neither the addition u/s. 56(2)(viib) is applicable particularly when the share issued at a price lesser than the value determined as per Discounted Cash Flow method. According to him, the determination of the FMV of the preference share can be done applying Rule 11 UA (1)(c)(c). Further that the rejection of the certificate issued by the CA determining the share value as an independent professional as per the provision of law is bad in law. It was further argued by him that no addition can be made u/s. 56(2)(viib) without first determining the FMV shares in terms of Rule 11 UA. As per the Ld.AR in view of the provisions under Sec. 56(2)(viib) of the Act read with Rule 11UA(2) of the Rules, the Ld.AO has no jurisdiction to adopt a different method than the one adopted by the assessee.
6. The Ld.AR further argued that since the Assessing Officer has doubt in accepting such valuation report and does not agree with the same, he his bound to make a reference to the Income Tax department valuation officer to determine the fair market value of such capital asset. On the other hand, the Ld.DR relied upon the order passed by the authorities below.

7. While confirming the addition made by the Ld.AO, the Ld.CIT(A) observed as follows:

“6.1.2 I have gone through the written submission filed by the appellant. The appellant has relied upon plethora of judgments. The appellant time and again mentions that projections and reliable future estimate should not be insisted upon and macro and micro economic factors should be considered, affecting the business. Hence, the AO has rightly relied upon the decision of jurisdictional High Court, which clearly held that "the Tribunal was perfectly justified in directing an enquiry into the FMV of shares of the assessee company which could have an implication of taxability u/s.2(22)(e) of the I.T. Act." The AO has rightly relied upon the judgment of Hon'ble Delhi ITAT, which held that in the absence of correctness of result of DCF Method, the AO is left with no option but to reject the DCF method and to go by NAV method to determine the FMV of the shares. Hence, the addition made by the AO is confirmed and grounds of appeal raised by the appellant are dismissed.”

8. It is a fact that the DCF method followed by the assessee is a hypothetical method of estimation and having no cogent basis been doubted by the Ld.AO. It is also a fact that considering the judgment passed by the Hon'ble Delhi Tribunal in case of M/s. Agro Portfolio Pvt. Ltd. vs. ITO in ITA No. 2189/Del/2018 for A.Y. 2014-15 wherein it has been held that when the correctness of result of the DCF method is doubted, it is no option left to the Ld.AO instead rejecting the DCF method and go by NAV method to determine the fair market value of the share. The fact appears in the case of M/s. Agro Portfolio Pvt. Ltd. is akin to the fact mentioned in the case before us. Instead of merchant valuer the value of preferential share has been determined by the CA. While

rejecting the case of the appellant, the Hon'ble Delhi Bench has been pleased to observe as follows:

“14. Even before the Ld.CIT(A) also, as recorded by the Ld. CIT(A) the assessee did not produce any evidence to substantiate the basis of projections in cash flow but relied on the valuer's report vehemently contending that such a report cannot be disturbed by the Ld. AO. At no point of time tried to explain where did the Ld. AO went wrong in his comments on the figures reflected in the above valuation report of the expert.

15. In these circumstances, we are unable to accept the contentions of the assessee that in view of the provisions under section 56(2)(viib) of the Act read with Rule 11UA(2) of the Rules the Ld. AO had no jurisdiction to adopt a different method than the one adopted by the assessee, and if for any reason the AO has any doubt recording such valuation report and does not agree with the same is bound to make a reference to the Income tax Department Valuation Officer to determine the fair market value of such capital asset. This is so because unless and until the assessee produces the evidences to substantiate the basis of projections in cash flow and provides reasonable connectivity between those projections in cash flow with the reality evidences by the material, it is not possible even for the Departmental Valuation Officer to conduct any exercise of verification of the ITA No. 2189/Del/2018 acceptability of the value determine by the merchant banker. This is more particularly in view of the long disclaimer appended by the merchant banker at page no. 16 & 17 of the paper book which clearly establishes that no independent enquiry is caused by merchant banker to verify the truth or otherwise the figures furnished by the assessee at least on test basis. The merchant bankers solely relied upon an assumed without independent verification, the truthfulness accuracy and completeness of the information and the financial data provided by the company. A perusal of this long disclaimer clearly shows that the merchant banker did not do anything reflecting their expertise, except mere applying the formula to the data provided by the assessee. We, therefore, are unable to brush aside the contention of the Revenue that the possibility of tailoring the data by applying the reverse engineering to the pre determined conclusions.

16. For all these reasons, we are of the considered opinion that there has not been any possibility of verifying the correctness or otherwise of the data supplied by the assessee to the merchant banker, in the absence of which the correctness of the result of DCF method cannot be verified. This left no option to the AO but to reject the DCF method and to go by NAV method to determine the FMV of the shares. Without such evidence, it serves no purpose even if the matter is referred to the Department's Valuation Officer. We, therefore, do not find any illegality or irregularity in the approach of conclusions are by the authorities ITA No. 2189/Del/2018 below. While confirming the same, we dismissed the appeal as devoid of merits."

9. We find that the facts mentioned in the above judgment is identical to that of the facts available before us. However, so far as the prayer for setting aside the issue to the file of the Ld.AO for a fresh consideration upon considering the report to be called for from the DVO is concerned, we do not find any merit in such submission rendered by the Ld.AR. Infact, we do not find any reason to interfere with the order passed by the authorities below in not accepting the valuation report so prepared by the CA in regard to the preferential share available to the assessee keeping in view the provisions of section 56(2)(viib) r.w.Rule 11UA and according to us, the value of preferential share is rightly taken as the value of the share at which the company should have received the preference share capital including the premium. Thus having regard to the facts and circumstances of the case, the finding of the authorities below to this effect that the share premium received by the company is in excess of fair market value of the share, the addition thus made u/s. 56(2)(viib) of

the Act is found to be just and proper particularly in view of the ratio laid down by Hon'ble Delhi Bench in case of M/s. Agro Portfolio Pvt. Ltd. vs. ITO (supra). The order passed by the authorities below is found to be without any ambiguity and thus, upheld. The assessee's appeal is therefore found to be devoid of any merit and therefore dismissed.

In the result, the appeal filed by the assessee stands dismissed.

Order pronounced in the open court on 12th September, 2023.

Sd/-
(CHANDRA POOJARI)
Accountant Member

Sd/-
(MADHUMITA ROY)
Judicial Member

Bangalore,
Dated, the 12th September, 2023.
/MS /

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|---------------|------------------------|
| 1. Appellant | 2. Respondent |
| 3. CIT | 4. DR, ITAT, Bangalore |
| 5. Guard file | |

By order

Assistant Registrar,
ITAT, Bangalore