INCOME TAX : Where assessee-company determined FMV of shares issued at premium on basis of discount cash flow (DCF) method and Assessing Officer changed same to net value added (NVA) method on ground that assessee's actual revenue varied from its projected revenue adopted for applying DCF method, since such variation between value of projected revenue and actual revenue was marginal and, further, there was no material to hold that assessee's projected revenue was fabricated, impugned change of method of valuation of shares was unjustified

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[2020] 122 taxmann.com 106 (Madras)

HIGH COURT OF MADRAS

Commissioner of Income Tax, Corporate Circle-3, chennai

v.

VVA Hotels (P.) Ltd.*

T. S. SIVAGNANAM AND
MRS. V. BHAVANI SUBBAROYAN, JJ.
TC APPEAL NO. 670 OF 2019†
SEPTEMBER 21, 2020

Section 56 of the Income-tax Act, 1961 and rule 11UA of the Income-tax Rules, 1962 - Income from other sources - Chargeable as (Share premium) - Assessment year 2013-14 - Assessee issued shares at premium and, accordingly, received share premium of certain amount - It determined fair market value of shares by adopting discount cash flow (DCF) method - Assessing Officer noted that projections of future profits adopted by assessee while applying DLF method for valuation was not accurate as same was in excess of actual sale revenue of assessee - Thus, he held that net asset value (NAV) method was an appropriate method - Accordingly, difference in valuation of shares was assessed as income from other sources under section 56(2)(viib) in hands of assessee - It was noted that Tribunal upon consideration of facts noted that variation between value of projected revenue and actual revenue of assessee was marginal - Further, there was no material to hold that assessee's projected sales revenue was fabricated - It further noted that Assessing Officer did not point out any flaw in method of calculation of value of shares by adopting DCF method but outrightly rejected same which should not be done - Whether, on facts, impugned change of method of valuation of shares and subsequent additions made under section 56(2)(viib) was unjustified and same were to be set aside - Held, yes [Paras 10 and 11] [In favour of assessee]

CASE REVIEW

CIT v. *Vaani Estates (P.) Ltd.* [2019] 107 taxmann.com 15/264 Taxman 310 (Mad.) (para 12) *Distinguished*.

CASES REFERRED TO

CIT v. *Vaani Estates (P.) Ltd.* [2019] 107 taxmann.com 15/264 Taxman 310 (Mad.) (para 11).

Ms. V. Pushpa, Sr. Standing Counsel *for the Appellant.* **Srinath Sridevan** *for the Respondent.*

JUDGMENT

T.S. Sivagnanam, J. - This appeal, by the Revenue filed under section 260A of the Income-tax Act, 1961 (hereinafter referred to as "the Act"), is directed against the order dated 26-3-2019, made in I.T.A.No.2013/Chny/2018 on the file of the Income-tax Appellate Tribunal 'C' Bench, Chennai for the assessment year 2013-14.

2. The following substantial questions of law have been raised by the Revenue for consideration of this Court:—

> "1.Whether on the facts and circumstances of the case and in law, the Tribunal was right in holding that provisions of section 56(2)(*viib*) cannot be invoked in the assessee's case?
>
> 2.Whether the Tribunal was right in holding that the assessee has adopted a method prescribed by the Income-tax Act, without considering the fact that the value of shares adopted by the assessee (under discounted case flow method) does not reflect the true market value of the shares on that date?"

3. The assessee, a Private Limited Company, filed its return of income for the assessment year under consideration (AY 2013-14) on 25-9-2013 admitting income of Rs. 12,86,360/-. The case was selected for scrutiny and notice under section 143(2) dated 3-9-2014 was issued. During the course of assessment, it was pointed out that the assessee company had issued 2,04,594 shares with a face value of Rs. 10/- and share premium of Rs. 1000/-per share. The assessee was directed to explain the method of valuation to substantiate the share premium collected. The assessee submitted that the value of shares were done by adopting the Discounted Free Cash Flow (DCF) method as per the report of the Chartered Accountant dated 12-2-2013 and accordingly, they allotted 1,16,278 shares to M/s.VVT Hotels Private Limited and 88,316 shares to Mr. Syed Irfan, Chennai, at Rs. 1010/- per share with a premium of Rs. 1000/- per share.

4. The Assessing Officer held that the assessee has been converted into a three star category hotel during the assessment year 2013-14 and the valuation done based on DCF method is by adopting the projections of future profits. This according to the Assessing Officer will not yield the true picture on the date of valuation, as the assessee has made only projection of revenue growth. The Assessing Officer took note of the returns filed by the assessee from the assessment years 2014-15 to 2016-17, compared the actual sale of services as per the returns filed by the assessee with that of the projected value in the DCF valuation. Thus, the Assessing Officer came to the conclusion that the assessee has made excessive projection of revenue without any reasonable basis. Accordingly, applied the provisions of Section 56(2)(viib) of the Act read with Rule 11UA(2) of the Income-tax Rules, 1957 (hereinafter referred to as "the Rules"). Ultimately, the Assessing Officer held that the Net Asset Value (NAV) method is the appropriate method, which should have been adopted for valuation of the shares and accordingly, computed the value and assessed the same at Rs. 18,51,22,790/- as income from other sources as per Section 56(2)(viib) of the Act, as the value of the shares sold, were unreasonable.

5. Challenging the said order dated 31-10-2016, the assessee preferred appeal before the Commissioner of Income-tax (Appeals)-11, Chennai [CIT(A)]. The CIT(A) by an elaborate order dated 20-3-2018 allowed the appeal. Aggrieved by the same, the Revenue preferred appeal before the Tribunal. The same was dismissed by the impugned order. Challenging the said order, the Revenue has filed this appeal contending that two substantial questions of law arise for consideration in this appeal.

6. We have elaborately heard Ms. V. Pushpa, learned Senior Standing Counsel appearing for the appellant/Revenue and Mr. Srinath Sridevan, learned counsel appearing for the respondent/assessee.

7. As noted, the CIT(A) has given elaborate reasons as to why the assessment order calls for interference. The CIT(A) noted the facts that the assessee company has established a new hotel in the central part of Chennai city and the construction was completed and the hotel was opened in the financial year 2012-13 relevant to the assessment year 2013-14. It was pointed out that considering the enterprise value of the business including market value of the land, the assessee company had issued 1,16,278 shares to its sister concern, M/s.VVT Hotels Private Limited, which had the same set of shareholders as that of the assessee company. The assessee allotted 88,316 shares to Mr. Syed Irfan, brother-in-law of Managing Director and Principal Shareholder of the assessee company, Shri Vikram Agarwal totally 2,04,594 shares with a face value of Rs. 10/- have been allotted under share premium of Rs. 1000/- per share. The assessee adopted the DCF method as available to it under Rule 11UA of the Rules for arriving at the value of the shares allotted and the share premium received. The CIT(A) noted that the Assessing Officer held that the projection made under Rule 11UA of the Rules is not accurate and there is excess projection of the sale revenue. The CIT(A) noted that the assessee has an option to adopt the NAV method or DCF method to arrive at the valuation of unquoted shares. It is relevant to point out that the CIT(A) very pertinently observed that unless the Assessing Officer is able to bring out any evidence of abuse of benevolent provisions with an intention to defraud the revenue, the option given to the assessee shall be held to be absolute. Further, after noting the percentage of the allotment of shares, the CIT(A) on facts found that the difference between the actual sales revenue over the years, *i.e.*, from assessment year 2013-14 to 2016-17 with that of the projected sales revenue adopted in the DCF method is very marginal.

8. On going through the figures of excess projection of sales, as mentioned by the Assessing Officer in a tabulated form in paragraph 4.2 of the assessment order, we find that the excess projection for 2013-14 was 10%, for 2014-15 - 4%, for 2015-16 - 8% and for 2016-17 - 18%. Therefore, the finding recorded by the CIT(A) that difference was marginal is found to be correct, though it may be stated that the difference of 18% for assessment year 2016-17 may be little on the higher side, but still unless and until there was material available with the Assessing Officer to pin down the assessee on the ground of fraud or misuse of the provisions of law, the adoption of the DCF method cannot be held to be wholly illegal. Further, the CIT(A) rightly took note of the nature of business, which was done by the assessee company and the vagaries of business atmosphere in the country in general and in Chennai in particular. Thus, on facts, the CIT(A) found that the assessee company has not abused the privilege of choosing the DCF method for arriving at the value of the shares instead of NAV method.

9. The Revenue contended before the Tribunal that the CIT(A) ignored the huge variation in value of shares to the extent of ten times between value adopted by the assessee company as against its actual value of underlying assets; the CIT(A) erred in ignoring the finding of the Assessing Officer that there is no basis for the discount factor adopted by the assessee company as at 16%. The assessee contended before the Tribunal that they had adopted the DCF method as available under Rule 11UA of the Rules for arriving at the value of the shares allotted and the share premium received whereas, the Assessing Officer adopted the NAV method and re-valued the land owned by the assessee company for the purpose of determining the share value of the premium thereof.

10. It was submitted that when the assessee has adopted a particular method of valuation as provided under the Act and Rules and in the absence of any material that such method was adopted to defraud the Revenue, merely because the Assessing Officer is of the view that NAV method alone has to be adopted is not a ground to reject the DCF method. The Tribunal upon consideration of the facts pointed out that the assessee has adopted the method of valuation as stipulated under Rule 11UA of the Rules and this accepted method of valuation does provide for estimation. Noting that the Assessing Officer had discarded the DCF method adopted by the assessee on the ground that the actual revenue varied from the projected revenue for four years, the Tribunal rightly noted that the projected value is an estimate and the variation in the estimate is marginal. Therefore, the Tribunal came to the conclusion that there was no material to hold that the assessee's projected sales revenues are fabricated or manipulated.

11. Furthermore, it was pointed out that the Assessing Officer did not point out any flaw in the method of calculation of the value of shares by adopting the DCF method but, out rightly rejected the same, which should not have been done. The Revenue by relying upon the decision of the Division Bench of this Court in *CIT* v. *Vaani Estates (P.) Ltd.* [2019] 107 taxmann.com 15/264 Taxman 310, submitted that the matter may be remanded to the Assessing Officer for fresh consideration to determine the fair market value of the shares in question as required in *Explanation* to Section 56 of the Act.

12. We find, in the said judgment, the matter was remanded to the Assessing Officer for fresh consideration on a concession extended by the assessee by submitting that they will seek necessary clarification from the Central Board of Direct Taxes and they may be permitted to do so while the matter could be remanded back to the assessing authority. Therefore, a direction issued based on the concession extended by the assessee cannot be relied upon by the Revenue as a precedent.

13. Thus, we find that both the CIT(A) and the Tribunal, on careful appreciation of the facts and circumstances, have granted relief to the assessee and we find there is no question of law, much less substantial question of law arise for consideration in this appeal.

14. Accordingly, the appeal filed by the Revenue is dismissed on the ground that there is no substantial question of law arise for consideration. No costs.

Tanvi

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*In favour of assessee.

†Arising out of order passed by ITAT in ITA No. 2013/Chny/2018, dated 26-3-2019.