

Pr. Commissioner Of Income Tax -1 vs Abhirvey Projects Private Limited on 5 February, 2024

Author: Yashwant Varma

Bench: Yashwant Varma, Purushaindra Kumar Kaurav

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IN THE HIGH COURT OF DELHI AT NEW DELHI

ITA 618/2023 & CM APPL. 58381/2023 (115 Days Dela

PR. COMMISSIONER OF INCOME TAX -1 Appellant

Through: Mr. Prashant Meharchandani,

Sr.SC with Mr. Akshat Sing

Jr.SC along with Ms. Ritik

Vohra, Adv.

versus

ABHIRVEY PROJECTS PRIVATE LIMITED

Through:

CORAM:

HON'BLE MR. JUSTICE YASHWANT VARMA

HON'BLE MR. JUSTICE PURUSHAINDRA KUMAR

KAURAV

ORDER

% 05.02.2024

1. Having heard Mr. Meharchandani, learned counsel appearing in support of the appeal and Mr. Jain, who appears for the respondent / assessee, we note that the principal question which arises for our consideration is the correctness of the Valuation Report dated 25 March 2015 which was submitted by the assessee in terms of the Section 56(2)(viii) of the Income Tax Act, 1961 ["Act"] and which has been rejected by the Assessing Officer ["AO"] as would be evident from the following findings:

"5.2 The Chartered Accountant (Valuer) has given hint of limitation of the valuation; which states that the valuation process has been carried out on the basis of the projected data provided to the valuer. The assessee has not provided any basis/documentary evidences in support of the projected data provided to the valuer; therefore, it is crystal clear that the reliability and correctness of the projected data This is a digitally signed order.

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by scanning the QR code shown above. The Order is downloaded from the DHC Server on 09/02/2024 at 21:53:03 are not based on any material. The assessee does not have any hidden assets in the form of patents, copy rights, intellectual property rights or even such investments etc belonging to the company based on which the assessee would be likely to substantially enhance its profits. On going through this report, it is seen that accountant has taken future cash flow as certified by the management. No verification of projections and assumptions adopted by management was made by the valuer, thereby making the report as per the requirement of the management. In DCF method future free cash flow is the most relevant variable which can change the value to any extent. 5.3 Further, it is seen that the loans/capital added to the "Profit after Tax" contains a figure of Rs. 5,00,00,000/- for the F.Y. 2013-14, whereas it is Rs. 3,01,00,000 only as per the comparative figures in the balance sheet submitted by the assessee during the course of assessment proceedings. This amount includes the borrowed funds of Rs. 2.70 Crores and the capital of Rs. 1 Lakh. Therefore, wrong figure of Rs. 5 Crores has been put in the respective column of the DCF calculation chart.

DCF analysis is a technique used in finance and real estate to discount future cash flows back to the present. The procedure for real estate valuation consists of three steps:

- Forecast the expected future cash flows
- Establish the required total return
- Discount the cash flows back to the present at the required rate of return

In the present case, the revenue projections provided by the management were merely self-serving figures which is evident from the final figures available in the return of income for the next two years i.e. for A.Y. 2016-17 and 2017-18.

Financial Year Projected Profit before tax Profit before interest, tax & depreciation.

2014-15 (A.Y. 2015-16)	7
2015-16 (A.Y. 2016-17)	2
2016-17 (A.Y. 2017-18)	3

5.4 Clause (viib) of sub section (2) of section 56 was inserted vide finance act, 2013 w.e.f. 01.04.2013 i.e. for A.Y. 2013-14 to provide that where a closely held company issues its shares at a price which is more than its fair market value then the amount received in excess of fair market value of shares will be charged to tax in the hand of the company as income from other sources. According to the provisions of Section 56(2)(viib) of the Income Tax Act, 1961 :

"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 This is a digitally signed order.

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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

(ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf. 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.

5.5 According to the provisions of Rule 11UA(2)(b), the assessee exercised the option of valuation of shares by DCF method. However, the actual fair market value of the shares as per DCF Method is given hereinabove. Therefore, it is clear that valuation made on the basis of unverified exorbitant forecasts given by management has given inflated value of shares @ Rs. 50.29/-. This is not as per recognized DCF method but as per whims & fancy of the management to arrive at higher value to issue shares at huge premium. Considering this the valuation of shares done by CA as per DCF method is found erroneous and non-reliable. Therefore, the value determined by the assessee is rejected and the shares are valued at negative net-worth as per the re-calculation above.

6. Therefore, following ingredients of Section 56(2)(viib) are satisfied:

a. The assessee company is not a company in which the public are substantially interested.

b. The assessee company has received, in any previous year, from the persons who are resident c. The assessee company has received the consideration for issue of shares.

d. The consideration so received exceeds the face value which is Rs. 10 for each of its 10,000 shares.

e. The aggregate consideration received for such shares is Rs. 12,16,00,000 and this amount exceeds the fair market value of the shares; which is determined at a negative amount.

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The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 09/02/2024 at 21:53:03 6.1 Therefore, the aggregate consideration received by the assessee in lieu of shares, exceeds the fair market value. It got clearly established that the assessee company's shares commanded merely its face value as FMV for the purpose of Section 56(2)(viib) and no share premium is chargeable on the issue of the shares of the assessee company.

Therefore, the share premium charged by the assessee company is hereby added back to the declared income of the assessee company as its "income from other sources" as envisaged in the provisions of Section 56(2)(viib) of the Income Tax Act, 1961.

7. I am satisfied that the assessee has furnished inaccurate particulars in respect of its income for the year in a bid to conceal its income. Therefore, penalty proceedings u/s 271(l)(c) of the Act have been initiated separately.

8. Subject to the above discussion, the income of the assessee company is computed as under:

1. Income / (Loss) from Rs. 5,34,710/-

Business & Profession

3. Add: U/s 56(2)(viib) of Rs.9,72,80,000/-

the Act (as discussed above)

4. Total taxable Income Rs.9,78, 14,710/-

9. Assessed at Rs. 9,78,14,710/- accordingly. Credit for prepaid taxes is given as per record. Interest is being charged under section 234A, 234B, 234C, 234D and 244A of the Act as applicable. Tax calculation along with interest is attached separately as ITNS- 150 which is part of this assessment order. Demand notice along with challan is being issued. Penalty proceedings u/s 271(1)(c) is being initiated as assessee has furnished inaccurate particulars of income concealed its income."

2. We note that before the Commissioner of Income Tax (Appeals) ["CIT(A)"] the submission of the respondent / assessee was as under:

"That, the assessee company has given advance amount to Rs.14,24,60,000/- to M/s AMB Homes Private Limited as capital advances against the equity shares who is the absolute owner of equity share of M/s AMB Build prop Private Limited who is having 18.75 acre (approx.) land at village Hayatpur, Tehsil & District Haryana. The same was also mentioned in the audited financial of the company for FY 2014-2015. M/s AMB Build prop Pvt. Ltd was in the process of obtaining license from HUDA for developing a commercial project at the said land. The future projections used in the valuation of the shares of the assessee This is a digitally signed order.

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Further, The assessee company was also allotted 11,98,200 equity shares as per detail given below:

S.no .	Name	Share Allotted
1	AMB Motels Pvt. Ltd	11,98,200

The allotment of shares in FY 2015-2016 was at the same price i.e. Rs.50/- each to M/s AMB Motels Private Limited in the next assessment year 2016- 2017 on the basis of same valuation of the shares according the DCF Method on dated 30.05.2015. The case of selected for limited scrutiny u/s 142(1) of the Income Tax Act, 1961 dated 27.11.2018. During the assessment proceedings, the assessee company filed various submissions on line along with the documents for allotment of shares, Valuation Certificate dated 25.03.2015& other relevant documents i.e ROC form PAS-3 for allotment of shares. The same are enclosed from Page no.47 to Based on the documents & facts submitted to the Ld.AO during the assessment proceeding for AY 2016-2017, The Ld. AO has issued Assessment order on dated 20.12.2018 without any addition to the Income of the assessee for Assessment year 2016-2017. Copy of the Assessment order is along with computation sheet is enclosed herewith on page no. 136 to 141. Therefore, your kind is requested to kindly consider our appeal to set aside the addition made by the Ld. AO and cancel the demand as per the assessment order for assessment year 2015-2016 along with the Penalty u/s 271(1)(c) and 271(1) (b) , Interest u/s 234A, 234B & 234C of the Income Tax Act,1961.

We shall also be happy to furnish any other information/ clarification as desired and assure you of prompt and fullest corporation in the matter."

3. It is on the aforesaid basis that the Income Tax Appellate Tribunal ["ITAT"] while considering the issue has proceeded to set aside the view as expressed by the AO bearing in mind the undisputed This is a digitally signed order.

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4. The ITAT has, in our considered opinion, rightly come to conclude that actual figures could not have been taken into consideration for the purposes of Section 56(2)(viib) of the Act. We find that the aforesaid position would also flow from the judgment of this Court in Pr.CIT vs. Cinestaan Entertainment Pvt. Ltd. [2021:DHC:780-DB] where it was held as follows:

"12. In this factual background, the learned ITAT then proceeded to examine whether the AO after invoking the deeming provision under Section 56(2)(viib), could have determined the FMV of the premium on the shares issued at nil after rejecting the valuation report given by the Chartered Accountant based on one of the prescribed methods under the Rules adopted by the valuer. On this aspect, after examining the statutory provisions and the factual position, the ITAT inter-alia observed as under:

"32. What is seen here is that, both the authorities have questioned the assessee's commercial wisdom for making the investment of funds raised in 0% compulsorily convertible debentures of group companies. They are trying to suggest that assessee should have made investment in some instrument which could have yielded return/profit in the revenue projection made at the time of issuance of shares, without understanding that strategic investments and risks are undertaken for appreciation of capital and larger returns and not simply dividend and interest. Any businessman or entrepreneur, visualise the business based on certain future projection and undertakes all kind of risks. It is the risk factor alone which gives a higher return to a businessman and the income tax department or revenue official cannot guide a businessman in which manner risk has to be undertaken. Such an approach of the revenue has been judicially frowned by the Hon'ble Apex Court on several occasions, for instance in the case of SA Builders, 288 ITR 1 (SC) and CIT vs. Panipat Woollen and General Mills Company Ltd., 103 ITR 66 (SC). The Courts have held This is a digitally signed order.

The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 09/02/2024 at 21:53:03 that Income Tax Department cannot it in the

armchair of businessman to decide what is profitable and how the business should be carried out. Commercial expediency has to be seen from the point of view of businessman. Here in this case if the investment has made keeping assessee's own business objective of projection of films and media entertainment, then such commercial wisdom cannot be questioned. Even the prescribed Rule 11UA(2) does not give any power to the Assessing Officer to examine or substitute his own value in place of the value determined or requires any satisfaction on the part of the Assessing Officer to tinker with such valuation. Here, in this case, Assessing Officer has not substituted any of his own method or valuation albeit has simply rejected the valuation of the assessee.

33. Section 56(2) (viib) is a deeming provision and one cannot expand the meaning of scope of any word while interpreting such deeming provision. If the statute provides that the valuation has to be done as per the prescribed method and if one of the prescribed methods has been adopted by the assessee, then Assessing Officer has to accept the same and in case he is not satisfied, then we do not find any express provision under the Act or rules, where Assessing Officer can adopt his own valuation in DCF method or get it valued by some different Valuer. There has to be some enabling provision under the Rule or the Act where Assessing Officer has been given a power to tinker with the valuation report obtained by an independent valuer as per the qualification given in the Rule 11U. Here, in this case, Assessing Officer has tinkered with DCF methodology and rejected by comparing the projections with actual figures. The Rules provide for two valuation methodologies, one is assets based NAV method which is based on actual numbers as per latest audited financials of the assessee company. Whereas in a DCF method, the value is based on estimated future projection. These projections are based on various factors and projections made by the management and the Valuer, like growth of the company, economic/market conditions, business conditions, expected demand and supply, cost of capital and host of other factors. These factors are considered based on some reasonable approach and they cannot be evaluated purely based on arithmetical precision as value is always worked out based on approximation and catena of underline facts and assumptions. Nevertheless, at the time when valuation is made, it is based on reflections of the potential value of business at that particular time and also keeping in mind underline factors that may change over the period of time and thus, the value which is relevant today may not be This is a digitally signed order.

The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 09/02/2024 at 21:53:04 relevant after certain period of time. Precisely, these factors have been judicially appreciated in various judgments some of which have been relied upon by the ld. Counsel, for instance:

i) Securities & Exchange Board of India & Ors [2015 ABR 291 (Bombay HC)] "48.6 Thirdly, it is a well settled position of law with regard to the valuation that valuation

is not an exact science and can never be done with arithmetic precision. The attempt on the part of SEBI to challenge the valuation which is by its very nature based on projections by applying what is essentially a hindsight view that the performance did not match the projection is unknown to the law on valuations.

Valuation being an exercise required to be conducted at a particular point of time has of necessity to be carried out on the basis of whatever information is available on the date of the valuation and a projection of future revenue that valuer may fairly make on the basis of such information."

ii) Rameshwaram Strong Glass Pvt. Ltd. v. ITO [2018- TIOL1358-ITAT- Jaipur) 4.5.2. Before examining the fairness or reasonableness of valuation report submitted by the assessee we have to bear in mind the DCF Method and is essentially based on the projections (estimates) only and hence these projections cannot be compared with the actuals to expect the same figures as were projected. The valuer has to make forecast on the basis of some material but to estimate the exact figure is beyond its control. At the time of making a valuation for the purpose of determination of the fair market value, the past history may or may not be available in a given case and therefore, the other relevant factors may be considered. The projections are affected by various factors hence in the case of company where there is no commencement of production or of the business, does not mean that its share cannot command any premium. For such cases, the concept of start-up is a good example and as submitted the income-tax Act also recognized and encouraging the start-ups.

iii) DQ(International) Ltd. vs. ACIT (ITA 151/Hyd/2015)

10. In our considered view, for valuation of an intangible asset only the future projections alone can be adopted and such valuation cannot be reviewed with actuals after 3 or 4 years down the line. Accordingly, the grounds raised by the assessee are allowed".

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34. The aforesaid ratios clearly endorsed our view as above. In any case, if law provides the assessee to get the valuation done from a prescribed expert as per the prescribed method, then the same cannot be rejected because neither the Assessing Officer nor the assessee have been recognized as expert under the law.

35. There is another very important angle to view such cases, is that, here the shares have not been subscribed by any sister concern or closely related person, but by an outside investors like, Anand Mahindra, Rakesh Jhunjhunwala, and Radhakishan Damania, who are one of the top investors and businessman of the country and if they have seen certain potential and accepted this valuation, then how AO or Ld. CIT(A) can question their wisdom. It is only when they have seen future potentials that they have invested around Rs.91 crore in the current year and also huge sums in the subsequent years as informed by the Ld. counsel. The investors like these persons will not make any investment

merely to give dole or carry out any charity to a startup company like, albeit their decision is guided by business and commercial prudence to evaluate a startup company like assessee, what they can achieve in future. It has been informed that these investors are now the major shareholder of the assessee company and they cannot become such a huge equity stock holder if they do not foresee any future in the assessee company. In a way Revenue is trying to question even the commercial prudence of such big investors like. According to the Assessing Officer either these investors should not have made investments because the fair market value of the share is Nil or assessee should have further invested in securities earning interest or dividend. Thus, under these facts and circumstances of the case, we do not approve the approach and the finding of the Id. Assessing Officer or Id. CIT(A) so to take the fair market value of the share at 'Nil' under the provision of Section 56(2)(viib) and thereby making the addition of Rs.90.95 crores. The other points and various other arguments raised by the Id.counsel which kept open as same has been rendered purely academic in view of finding given above.

36. Other grounds are either consequential or have become academic, hence same are treated as infructuous. In the result appeal of the appellant assessee is allowed.

13. From the aforesaid extract of the impugned order, it becomes clear that the learned ITAT has followed the dicta of the Hon'ble Supreme Court in matters relating to the commercial prudence of an assessee relating to valuation of an asset. The law requires determination of fair market values as per prescribed methodology.

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The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 09/02/2024 at 21:53:04. The Appellant-Revenue had the option to conduct its own valuation and determine FMV on the basis of either the DCF or NAV Method. The Respondent-Assessee being a start-up company adopted DCF method to value its shares. This was carried out on the basis of information and material available on the date of valuation and projection of future revenue. 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. Furthermore, as noted in the impugned order and as also pointed out by Mr. Vohra, the shares in the present scenario have not been subscribed to by any sister concern or closely

related person, but by outside investors. Indeed, if they have seen certain potential and accepted this valuation, then Appellant-Revenue cannot question their wisdom. The valuation is a question of fact which would depend upon appreciation of material or evidence. The methodology adopted by the Respondent-Assessee, accepted by the learned ITAT, is a conclusion of fact drawn on the basis of material and facts available. The test laid down by the Courts for interfering with the findings of a valuer is not satisfied in the present case, as the Respondent-Assessee adopted a recognized method of valuation and Appellant-Revenue is unable to show that the assessee adopted a demonstrably wrong approach, or that the method of valuation was made on a wholly erroneous basis, or that it committed a mistake which goes to the root of the valuation process.

14. In view of the foregoing, we find that the question of law urged by the Appellant-Revenue is purely based on facts and does not call for our consideration as a question of law.

15. For the foregoing reasons, the appeal is dismissed along with pending application."

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5. Mr. Meharchandani, however, contends that even if the ITAT were convinced that the methodology as adopted by the AO was not liable to be countenanced, once the Valuation Report itself had not been accepted, the end of justice would have warranted the matter being remitted to the AO for the purposes of carrying out the valuation afresh and in accordance with law.

6. There is however, presently, a dispute with respect to the recordal of facts by the AO in its order and who has observed in paragraph 5.2 extracted above that the material which was provided to the valuer for the purposes of preparation of DCF Report had not been presented in assessment proceedings. This is seriously disputed by Mr. Jain who contends that the requisite material had in fact been placed in the course of assessment.

7. In view of the aforesaid we call upon Mr. Meharchandani to obtain instructions and apprise us as to the correctness of the observation of the AO that it had not been provided any basis / documentary evidence in support of the projected data provided to the valuer.

8. Let the relevant record consequently be produced before us or instructions obtained on or before the next date fixed.

9. Let the matter be called again on 05.04.2024.

YASHWANT VARMA, J.

PURUSHAINDRA KUMAR KAURAV, J.

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