

Milk Mantra Dairy (P) Ltd., Bhubaneswar vs Dcit, Cir.-12(1), Kolkata on 4 July, 2022

IN THE INCOME TAX APPELLATE TRIBUNAL "B" BENCH KOLKATA

BEFORE SHRI ABY T. VARKEY, JUDICIAL MEMBER
AND SHRI GIRISH AGRAWAL, ACCOUNTANT MEMBER

ITA No.413/Kol/2020
Assessment Year: 2013-14

Milk Mantra Dairy Pvt. Ltd. PAN: AAGCM1112L	Deputy Commissioner Income-tax	of
Vs.		
7th floor, Z Tower, Patia Nandan Kanan Road, Bhubaneswar-751024. (Appellant)	Circle-12(1) Kolkata. (Respondent)	

Present for:

Appellant by : Shri Rajib Sharma & Shri Jai Somani, ARs
Respondent by : Shri Sudipta Guha, CIT, DR

Date of Hearing : 05.04.2022
Date of Pronouncement : 04.07.2022

ORDER

PER GIRISH AGRAWAL, ACCOUNTANT MEMBER:

This appeal by the assessee is arising out of the order of CIT(A)-4, Kolkata in appeal no. 491/CIT(A)-4/16-17 dated 03.02.2020 against the assessment order of DCIT, Circle-12(1), Kolkata passed u/s. 143(3) of the Income-tax Act, 1961 (hereinafter referred to as the "Act") dated 13.01.2017.

2. There is a delay of 73 days in filing the present appeal for which a petition for condonation of delay is placed on record. From the condonation petition, we note that the present appeal ought to have been filed on or before 17.04.2020 which falls during the lockdown period on account of Pandemic of Covid-19. It is requested by the assessee that since it is prevented by sufficient and reasonable cause, the delay of 73 days in filing the appeal may be condoned and appeal be admitted for meritorious disposal. We have heard both the sides and find that vide order dated 10.01.2022, Hon'ble Supreme Court has directed that the period from 15.03.2020 to 28.02.2022 is to be excluded for the purpose of computing the Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 limitation period during the COVID-19 pandemic. Further, a period of 90 days is allowed after 28.02.2022 vide same order. Considering the facts and the explanation of the assessee, we condone the delay in filing the appeal and admit it for adjudication.

3. Grounds taken by the assessee in the present appeal are reproduced as under:

1. That on the facts and in the circumstances of the case, the learned CIT(Appeals) erred in confirming addition made by the Assessing Officer to the extent of Rs. 6.8 crores as share premium in excess of Fair Market Value under section 56(2)(viib) of the Act;

2. That on the facts and in the circumstances of the case, the learned CIT(Appeals) grossly erred in upholding the action of the Assessing Officer in disallowing share premium of Rs 3.7 crores u/s 56(2)(viib) received in respect of shares issued to a venture capital fund and those issued to non-

residents of Rs. 0.6 crores on conversion of compulsory convertible debentures (CCDs) without appreciating that the first proviso to section 56(2)(viib) specifically excludes such category of shareholders from the applicability of the section;

3. That on the facts and in the circumstances of the case, the learned CIT(Appeals) erred in disallowing an amount of Rs 2.9 crores without appreciating that the consideration was first received on account of CCDs in FY 2010-11 and FY 2011-12 prior to introduction of Section 56(2)(viib) from 1 April 2012 and CCDs were merely converted to equity shares during the year.

4. That without prejudice to the ground taken above, the learned CIT(Appeals) erred in confirming the disallowance made by the Assessing Officer to the extent of Rs 6.8 crores under section 56(2)(viib) of the Act without giving any cognizance to the sharp valuation report and without appreciating that the shares have been issued at a price not exceeding the Fair Market Value (FMV) of the shares.

5. That on the facts and in the circumstances of the case, the learned CIT(Appeals) erred in upholding the action of the Assessing Officer in rejecting the Assesses' Discounted Free Cash Flow Method and adopting book value method for valuation of shares without any legal basis.

3.1. From the perusal of grounds of appeal above, we note that the following issues are involved in the present appeal before us which relates to addition made u/s. 56(2)(viib) of the Act:

Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 a. Applicability of section 56(2)(viib) of the Act on the transaction of conversion of Compulsorily Convertible Debentures (CCDs) into Equity Shares of the assessee. b. Applicability of exclusion clauses of section 56(2)(viib) of the Act on certain transactions with Venture Capital Fund and Non-residents.

c. Applicability of Rule 11UA of the Income-tax Rules, 1962 (the Rules) for valuation method opted for valuation of equity shares issued by the assessee.

d. Valuation arrived at by the assessee of the equity shares issued by the assessee.

4. Before us, Shri Rajib Sharma and Shri Joy Somani represented the assessee and Shri Sudipta Guha, CIT, represented the Department.

5. Brief facts of the case are that assessee is a private limited company engaged in the manufacturing and selling of dairy products like pasteurized milk, cottage cheese, curd, flavoured milk shake, etc. which primarily caters to the domestic market and has its manufacturing facilities in Konark, Orissa. During the year under consideration, assessee issued 13,40,629 equity shares of face value of Rs. 10/- per share at premium to various parties including Venture Capital Funds, Non-residents and other angel investors, details of which is tabulated as under:

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A.Y. 2013-14 5.1. Face value of equity shares issued by the assessee @ Rs.10/- per share is Rs.1,34,06,290/- and share premium of Rs. 16,11,00,710/-, thus, totaling to the issue price of Rs.17,45,07,000/-. In the course of assessment proceedings, ld. AO alleged that the issue of equity shares has been made over and above the Fair Market Value (FMV) and applied the provisions of rule 11UA(2)(a) of the Rules by adopting Net Asset Value method/Book Value method (NAV) for computing the FMV and thus, proceeded to add the entire issue price of equity shares in the sum of Rs.17,45,07,000/- u/s. 56(2)(vii)(b) of the Act as income from other sources. Ld. AO adopted the figures from the audited Balance Sheet of the assessee as on 31.03.2012 for calculating the FMV of equity shares by applying NAV method and calculated it at negative Rs.294/-. Since the FMV under rule 11UA of the Rules was calculated at a negative figure of Rs.294/-, ld. AO treated it as 'nil' and thus completed the assessment by making the addition towards aggregate Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 consideration of Rs.17,45,07,000/-. Aggrieved, assessee went in appeal before the Ld. CIT(A).

6. In the course of first appellate proceedings, ld. CIT(A) gave partial relief to the assessee by deleting the addition of Rs.9,24,03,061/- pertaining to share premium received from non-residents by holding that the provision of section 56(2)(vii)(b) of the Act is applicable only on proceeds received from residents. Ld. CIT(A) also gave relief by deleting the addition of Rs.1,34,06,290/- pertaining to the receipt of face value of shares by holding that provision of section 56(2)(vii)(b) of the Act is applicable only on the "consideration for issue of shares that exceeds the face value of share" i.e. only share premium and not the face value of the shares. On the relief granted by the ld. CIT(A), it was submitted by the ld. Counsel that the department is not in appeal before the Tribunal which is not controverted by ld. CIT, DR. The balance addition of Rs.6,86,97,649/- made by ld. AO was confirmed by the ld. CIT(A), details of which is tabulated as under:

7. Aggrieved, the assessee is in appeal before the Tribunal.

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8. Ld. Counsel for the assessee has placed on record a synopsis containing 20 pages along with a paper book of 367 pages and a case law compendium containing 19 citations running in 453 pages.

9. In the course of hearing, Ld. Counsel took the bench through each of the grounds in appeal, which is discussed hereinafter.

10. We note from the table in para 6 above for which the assessee is in appeal before the Tribunal that except for the amount of Rs. 6,51,417/-, rest of the amounts for which addition has been made, pertains to conversion of CCDs into equity shares. Accordingly, at the outset, we find it proper to deal with the very first issue listed above in para 3.1 in respect of applicability of section 56(2)(viib) of the Act on the transaction of conversion of Compulsorily Convertible Debentures (CCDs) into Equity Shares of the assessee which is essentially covered in ground no. 1 and 3 taken by the assessee.

11. Brief facts in respect of issuance of equity shares against the conversion of CCDs are that during AY 2010-11, the assessee vide Investment Agreement dated 31.01.2011 entered into an agreement with its investors for issuance of CCDs of Rs.7,40,80,000/- at face value of Rs.100/- each, spread over various tranches. Assessee issued CCDs amounting to Rs.7,18,92,500/- during AYs 2011-12 and 2012-13 which have been subsequently converted into equity shares in AY 2013-14 i.e. the year under consideration before us in this appeal, at the pre- determined value range for conversion into equity shares of the assessee.

11.1 Investment agreement dated 31.01.2011 is placed on record in the paper book from page no. 280 to 364. Under the definition clause of this Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 agreement, there are certain definitions which are relevant to the issue in hand before us and are, therefore, reproduced for ease of reference:-

"1.31 "Conversion" shall mean the conversion of CCDS into Conversion Shares in the manner as set out in this Agreement;

1.32 "Conversion Shares"" shall mean the Equity Shares issued to each Investor upon Conversion of the Investor CCDs;

1.33 "Debenture Holders" shall mean holders of Investor CCDS issued by the Company;

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1.37 "Equity Shares" shall mean the equity shares of par value of Rs.10 each (Rupees Ten only) of the Company or any other issued Security of the Company that is reclassified, re-organised, reconstituted or converted into Equity Shares and includes the Conversion Shares;

1.38 "Encumbrance" means (i) any mortgage, charge (whether fixed or floating), pledge, lien, hypothecation, assignment, deed of trust, security interest or other encumbrance of any kind securing, or conferring any priority of payment in respect of, any obligation of any Person, including any right granted by a transaction which, in legal terms, is not the granting of security but which has an economic or financial effect similar to the granting of security under applicable law; (ii) any voting agreement, interest, option, right of first offer, refusal or Transfer restriction in favour of any Person; and (iii) any adverse claim possession or use;

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1.85 "Shareholders" mean the shareholders of the Company from time to time and shall include the Investors as and when Conversion of any of the Investor CCDs takes place;

1.86 "Shareholding" shall mean the respective percentage proportions in which the share capital of the Company is held from time to time by the Shareholders on a Fully Diluted Basis;"

11.2 There is an Annexure No. 4 forming part of the Investment Agreement which sets out the CCDs terms and conditions. Certain terms and conditions which are relevant, are extracted for ease of reference:-

"1.1. Status: The CCDs constitute direct, unconditional, unsubordinated and unsecured obligations of the Company and shall at all times rank pari passu and without any preference or priority among themselves and shall at all times rank at least equally with all other present and future direct, unconditional, unsubordinated and unsecured obligations of the Company (save for such exceptions as may be provided by mandatory provisions of Applicable Law)."

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1.5 Interest

a) Interest Rate

(i) Each of the CCDs will bear interest on the face value from and including the date of issue (i.e., the First Closing Date and the Second Closing Date as applicable) up to the date of Conversion of the CCDs at the rate of 0.01% per annum, compounded on a quarterly basis, until the Conversion of the CCDs into the Conversion Shares ("Interest").

(ii) Interest on the CCDs will be calculated on the basis of the actual number of days in the relevant period and divided by 360 ("Interest Period").

b) Interest Payment i. Interest on the CCDs shall be on an accrual basis and the total interest due and payable by the Company to each of the Investors shall be added to the Subscription Amount for the purpose of calculation of the number of Conversion Shares to be issued by the Company to such Investors.

1.7. Acknowledgement of Liability: The Company hereby acknowledges its liability to the Debenture Holder in respect of the CCDs and covenants with the Debenture Holder that, as and when the CCDs are due to be converted in accordance with the provisions of the Agreement, the Company will effect such Conversion in accordance with the terms of Agreement. The Debenture Holder from time to time shall have the benefit of, be entitled to enforce, be bound by, and are deemed to be have notice of all obligations, liabilities, agreements, undertakings, covenants, warranties and other provisions in the Agreement."

11.3 Also, there is Annexure No. 5 which sets out the conversion mechanism in terms of the investment agreement and the relevant extract from para 1 and 2 of this Annexure which provides for the entitlement on conversion is reproduced as under:-

1. Right to Convert: The Debenture Holder shall be entitled to have the CCDs converted into Equity Shares in the manner as set out in this Annexure 5.

2. Entitlement on Conversion

(a) Upon Conversion, each Debenture Holder shall be entitled to receive such number of Conversion Shares for the CCDs held by the Debenture Holder.

(b) The Conversion Shares issued to the Debenture Holder pursuant to the Conversion shall be transferable to any Person, subject to the terms of the Agreement.

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(c) The Conversion Shares issued to the Debenture Holder pursuant to the Conversion shall be of the same face value and shall be pari passu in every respect with the comparable Equity Shares of

the Company then outstanding, and shall be issued at the Conversion Price to the Debenture Holder.

11.4 Further, there is Annexure No. 6 to the same agreement which lists down the warranties wherefrom under Clause (1) titled as subscription, relevant clauses are extracted as under:-

"1.1. The issue of Investor CCDs respectively shall be in compliance with Applicable Law.

1.2. The Investor CCDs shall rank pari passu with the equivalent class of shares of the Company upon Conversion, in all respects, including, but not limited to, rights shares, bonus and pro-rata dividends, except as otherwise provided in the Investor Rights Agreement.

1.3. Upon consummation of all the transactions contemplated by this Agreement, the Investor shall, at First Closing, Second Closing and Third Closing, acquire good, valid and marketable title to the Investor CCDs, free and clear of all liens, claims and Encumbrances."

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11.5 During the impugned year, when the conversion of CCDs into equity shares took place, assessee issued 13,40,649 equity shares to various parties including venture capital funds, non-residents and other angel investors. Details of equity shares issued by the assessee are tabulated as under:-

Number of equity shares issued	13,40,629
Face Value of equity shares (Rs.)	1,34,06,290
Share Premium on the issue of equity shares (Rs.)	16,11,00,710
Total issue price for equity shares (Rs.)	17,45,07,000

11.6 During the course of hearing, Id. Counsel for the assessee vehemently submitted that the entire consideration was received by the assessee at the time of issuance of CCDs i.e., in AY 2011-12 and AY 2012-13. According to him, conversion of CCDs by issuing equity shares did not entail any further payment of money. He further Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 submitted that the provision of Section 56(2)(viib) of the Act cannot be applied since this was not in existence in the statute when the money was received by the assessee on issue of CCDs. Id. Counsel for the assessee submitted that the conversion price was pre-determined which was agreed upon between the parties in terms of investment agreement entered into by the parties prior to the insertion of Section 56(2)(vii) of the Act. He submitted that the investment agreement

provides for the issue price range which is between Rs.60/- per share to Rs.180/- per share. He then placed reliance on the decision of the co-ordinate bench of ITAT Delhi in the case of India Today Online (P.) Ltd. v. ITO [2019] 104 taxmann.com 385 (Delhi - Trib.) wherein it was held that "Once the computation mechanism as per new prescribed method was not available at the time of issuance of shares, then it is unfathomable to apply such method so as to reject the assessee's valuation and assessee cannot be expected to comply with the method when it was notified subsequent to the date of allotment of the shares." He also submitted that the provisions of Section 56(2)(viib) of the Act having introduced w.e.f. 01.04.2013 i.e. from AY 2013-14 and since the assessee has received the amount on issuance of CCDs in the preceding two years i.e. AY 2011-12 and AY 2012-13, section 56(2)(viib) of the Act will not be applicable and the sum so received will not be chargeable to tax under the aforesaid section. He further placed reliance on the decision of the Co-ordinate Bench of ITAT Kolkata in the case of ACIT vs. Diach Chemicals & Pigments Pvt. Ltd. in ITA No. 546/Kol/2017 for AY 2013-14 order dated 19.06.2019 wherein it was held that since the amount for allotment was received by the assessee in AY 2012-13 and the allotment of shares was done in AY 2013-14, the provisions of Section 56(2)(viib) of the Act cannot be applied in the year of allotment of shares.

11.7 Per contra, ld. CIT DR relied on the order of the ld. CIT(A) and the ld. AO and emphasized that the section 56(2)(viib) of the Act is Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 applicable since the conversion of CCDs into equity shares took place in the year in which the said section is in force. He also submitted that it is undisputed that the provisions of section 56(2)(viib) of the Act are applicable from AY 2013-14 which is also the year under consideration in the present appeal.

12. Having heard both the parties and after giving thoughtful consideration to the submissions made and documents placed on record, let us first apprise ourselves on the applicable law as enunciated u/s. 56(2)(viib) of the Act, which is reproduced as under for ease of reference:

"56(1)

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:--

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(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:

Provided further that where the provisions of this clause have not been applied to a company on account of fulfillment of conditions specified in the notification issued under clause (ii) of the first proviso and such company fails to comply with any of those conditions, then, any consideration received for issue of share that exceeds the fair market value of such share shall be deemed to be the income of that company chargeable to income-tax for the previous year in which such failure has taken place and, it shall also be deemed that the company has under reported the said income in consequence of the misreporting referred to in sub-section (8) and sub-section (9) of section 270A for the said previous year.

Explanation: - For the purposes of this clause,--

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(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;

(aa) "specified fund" means a fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) or regulated under the International Financial Services Centres Authority Act, 2019;

(ab) "trust" means a trust established under the Indian Trusts Act, 1882 (2 of 1882) or under any other law for the time being in force;

(b) "venture capital company", "venture capital fund" and "venture capital undertaking" shall have the meanings respectively assigned to them in clause (a), clause (b) and clause (c) of Explanation to clause (23FB) of section 10;"

[emphasis supplied by us by bold for the relevant portions of the provision] 12.1 It is uncontroverted and undisputed that the provisions of Section 56(2)(viib) of the Act having been introduced w.e.f. 01.04.2013 are applicable to AY 2013-14 which is the year under consideration in the appeal before us. In the present case, it is a fact that CCDs have been converted into equity shares of the assessee in AY 2013-14.

12.2 The word "convertible" is used in common parlance to denote a security which is not equity share but some other security such as preference share, debentures, bonds or warrants which is converted into equity share on pre-determined conditions. "Convertible" means changeable from one kind or form to another. It means a security that the owner has a right to convert it into a share.

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A.Y. 2013-14 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 favorable to various stakeholders of the assessee making it more investor attractive/lucrative.

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(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. The conversion of CCDs into equity shares in AY 2013-14 entails receipt of consideration by the assessee which is translated into the total issue price of 17,45,07,000/- including share premium of Rs.16,11,00,710/-, tabulated in para 11.5 above.

12.5 Contention canvassed by the assessee is in respect of receipt of any consideration upon conversion of CCDs into equity shares is within a restricted and very narrow window of looking at only "receipt of money", to which our views do not ascribe to.

12.6 In our considered view, the provisions of Section 56(2)(viib) of the Act do apply in the present case which involves receipt of consideration (indicative list enumerated above) by the assessee on conversion of CCDs into equity shares, more particularly when the law is in force in the impugned year i.e. AY 2013-14, the year of conversion. The view canvassed by the Id. Counsel for the assessee as noted above, if acceded to by us, will make the provisions of section 56(2)(viib) otiose for all such transactions of conversion of securities. On the decisions of the Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 Co-ordinate Benches of ITAT in the case of Diach Chemicals & Pigments Pvt. Ltd. (supra) and India Today Online (P) Ltd. (supra), on which Id. Counsel of the assessee placed reliance are distinguishable on facts since the transactions dealt therein were not that of conversion of securities but receipt of share application money and allotment of shares thereon which was executed into two different accounting years and hence are not applicable to present factual matrix of the case. Accordingly, we hold that in the present case, the assessee is in receipt of consideration on conversion of CCDs into equity shares to which the provisions of Section 56(2)(viib) of the Act are applicable. Relevant ground of appeal is accordingly dismissed.

13. Having so held on the applicability of section 56(2)(viib) of the Act in terms of above para, we now take up the claim of the assessee for exclusion of share premium relating to conversion of CCDs into equity shares with VCF and Non-residents, essentially dealt by ground no. 2.

13.1 Ground no. 2 relates to share premium of Rs.3,68,75,000/- from Aavishkar India Micro Venure Capital Fund (Aavishkar) and Rs.64,53,066/- from certain non-residents claimed as not chargeable u/s. 56(2)(viib) of the Act, those being Venture Capital Fund and Non- residents.

13.2 By referring to the first proviso to section 56(2)(viib) of the Act, Id. Counsel for the assessee submitted that share premium received by the assessee on issue of equity shares from Aavishkar is not chargeable to tax since Aavishkar is a 'Venture Capital Fund' (VCF) and the assessee is a 'Venture Capital Undertaking' (VCU), both of which falls within exclusion clause (i) of the first proviso to section 56(2)(vii)(b) of the Act.

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A.Y. 2013-14 13.3 To understand the definition of 'Venture Capital Fund' and 'Venture Capital Undertaking', useful reference was made by the Id. Counsel to the explanation to section 10(23FB) of the Act. Relevant portion of the said section is reproduced for ease of reference.

13.4 To substantiate his claim, Id. Counsel referred to the certificate dated 28.05.2002, issue by Securities Exchange Board of India (SEBI) acknowledging the status of Aavishkar as VCF which is placed at page 62 of the paper book. Further, to demonstrate that the assessee falls within the definition of Venture Capital Undertaking (VCU), Id. Counsel referred to the SEBI (VCF) Regulations, 1996 wherein u/s. 2(n) it is defined as under:

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A.Y. 2013-14 13.5 By referring to this definition of VCU, Id. Counsel emphasized that all the conditions are fulfilled by the assessee to hold it as a VCU, i.e. to say -

(a) Shares of assessee are not listed on a recognized stock exchange.

(b) Assessee is engaged in the production or manufacture of articles i.e. dairy products.

(c) Assessee is not engaged in services provided in the negative list defined in Regulation (j) stated in third schedule of SEBI (VCF) Regulations, 1996.

13.6 For further ensuring that assessee is not engaged in services mentioned in the negative list referred above, the contents of negative list were referred to which are reproduced below:

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A.Y. 2013-14 13.7 By referring to the negative list, Id. Counsel thus submitted that assessee is neither into non-banking financial services, gold financing, activities not promoted under industrial policy of Govt. of India nor in any other activity specified by the board from time to time. Id. Counsel also pointed out that similar definition of

Venture Capital Undertaking is contained in regulation 2(1)(aa) of Master Alternative Investment Funds Regulation, effective from 21.05.2012 which has replaced SEBI (VCF) Regulations, 1996. Ld. Counsel thus stated that the share premium of Rs.3,68,75,000/- from the issue of equity share to Aavishkar falls in the exclusion clause mentioned in first proviso to section 56(2)(vii)(b) of the Act since Aavishkar is a Venture Capital Fund and assessee is a Venture Capital Undertaking. Before we proceed on the issue in hand, it is worth noting of fact that assessee had made an investment agreement with certain investors including Aavishkar for issuance of Compulsorily Convertible Debentures (CCDs) of Rs.7,40,80,000/- of face value of Rs.100/- over various tranches. The Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 share premium from Aavishkar was a result of conversion of CCDs into equity shares of the assessee company. The issue of whether conversion of CCDs into equity shares is covered by section 56(2)(vii)(b) of the Act has already been dealt separately in above para holding it to be covered u/s 56(2)(viib) of the Act.

13.8 Ld. CIT, DR relied on the order of ld. CIT(A) and ld. AO. From the detailed elucidation by the Ld. Counsel on the coverage of transaction with Aavishkar to demonstrate that it is a Venture Capital Fund and that the assessee is a Venture Capital Undertaking, falling within the exclusion clause of section 56(2)(vii)(b) of the Act, we note that Aavishkar is a VCF as is evident from the certificate issued by SEBI placed on record at page 6 of the paper book. Also, ld. Counsel demonstrated that assessee falls within the definition of Venture Capital Undertaking enumerated above. We find that the transaction of issue of equity shares to Aavishkar is covered by clause (i) in first proviso to section 56(2)(vii)(b) wherein it states that section 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. Accordingly, we direct to delete the addition so made in this respect.

13.9 Another part of ground no. 2 relates to addition of Rs.64,52,066/- in respect of share premium received from certain other non-resident angel investors, list of which is tabulated as under:

Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 13.10 In this respect, ld. Counsel for the assessee submitted that the issuance of equity shares to its non-resident angel investors was by way of conversion of CCDS into equity shares in the impugned year but since these are non-residents, provision of section 56(2)(viib) is not applicable. Ld. Counsel for the assessee further submitted that ld.

CIT(A) already deleted the addition of Rs.9,24,02,061/- as noted above in respect of amount received from non-resident company i.e. Aavishkar India (II) Company Ltd. (AICL) against which Department is not in appeal and therefore no addition can be made in respect of share premium on the equity shares issued to the other non-resident angel investors on conversion of their CCDs. To demonstrate that these other non-resident angel investors are in fact non-residents, ld. Counsel

referred to the submission made before the Id. CIT(A) by stating that Foreign Direct Investment (FDI) is allowed upto 100% under the automatic route for which copy of FC-GPR forms filed with RBI for issue of shares to non-resident were placed on record at page 91 to 100 in the paper book. This being an uncontroverted fact, we are inclined to accept the submission made by the Id. Counsel and direct the AO to delete the addition of Rs.64,53,066/- made in respect of share premium on equity shares issued to these non-residents angel investors. While holding so, we also draw our force from the decision of Co-ordinate bench of ITAT, Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 Kolkata in the case of Chryso India Pvt. Ltd. (2019) 109 taxmann.com 16 (Kol) dated 19.06.2019, wherein at para 24, it is held that provisions of section 56(2)(vii)(b) of the Act does not apply to consideration received from a non-resident. Accordingly, ground no. 2 of the appeal by the assessee is allowed. We make it explicitly clear that our finding to exclude these transactions with VCF from the chargeability of it u/s 56(2)(viib) of the Act is in terms of clause (i) in first proviso to section 56(2)(vii)(b) and reference to 'receipt from any person being residents' in section 56(2) and not on the claim of the assessee that there is no receipt of any consideration on conversion of CCDs into equity shares which we have already held rejected.

14. We now take up the two inter-twined issues relating to valuation method and the valuation arrived therein covered by ground no. 4 and 5 which relates to valuation of equity shares issued on conversion of CCDs. This inter-twined issue which needs our deliberation is on the valuation of equity shares which ultimately leads to the quantification of the addition to be made u/s 56(2)(viib) in the hands of the assessee in the form of excess of aggregate consideration over and above the fair market value of the equity shares.

14.1 To arrive at the FMV of unquoted equity share, rule 11UA(2) of the Rules provide for its computation mechanism which is reproduced as under:

Determination of fair market value.

11UA. (1).....

(2) 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:--

(A-L)

(a) the fair market value of unquoted equity shares = \times (PV), (PE) Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 where,

.....; OR

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

[emphasis supplied by us by bold and underline] 14.2 From the above, the two methods prescribed in Rule 11UA(2)(a) and (b) are at the option of the assessee. We note that assessee has strongly agitated vide ground no. 4 and 5 on the issue of change of method for valuation of equity shares to NAV method by the ld. AO when the DCF method has been opted and adopted by the assessee as prescribed in the said rule. Ld. Counsel submitted that ld. AO cannot disregard the method used by the assessee and change it without scrutinizing the valuation report furnished by the assessee which was done by taking DCF method. Ld. Counsel reiterated that indicative value agreed upon by the assessee and the investors in the year 2011 when the investment agreement was executed, clearly demonstrates that the company valuation was anticipated to be in the range of Rs. 60 to Rs. 180/- per share falls in the same range as arrived at in the valuation report placed on record by opting DCF method. He further submitted that assessee had obtained the valuation report in accordance with the provision of Rule 11UA(2)(b) of the Rules from an independent Chartered Accountant and the ld. AO has not pointed out any specific discrepancy in the said report but has merely rejected the valuation on the basis of comparison of the projected figures with the actual results, which is devoid of any merits.

14.3 For the contention that the change of method of valuation by the ld. AO is beyond the scope of law since rule 11UA(2) provides an option only to the assessee to choose either of the two prescribed methods. For this contention, he placed reliance on the decision of Hon'ble High Court of Bombay in the case of Vodafone M-Pesa Ltd. v. DCIT [2018] 92 Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 taxmann.com 73 (Bom) wherein the Hon'ble High Court had categorically held that "there is certainly no immunity from scrutiny of the valuation report submitted by the assessee. Therefore, the AO is undoubtedly entitled to scrutinize the valuation report and determination afresh either by himself or by calling for a final determination from an independent valuer to confront the petitioner. However, the basis has to be the DCF method and it is not open to him to change the method of valuation which has been opted for by the Assessee."

14.4 In respect of contention raised by the assessee on the aspect of rejection of valuation report by comparing projection to actual results, ld. Counsel for the assessee submitted that the very foundation of DCF method is based on deriving the FMV of shares from the present valuation of future cash flows which may or may not correctly match with the facts and circumstances in the future. He relied on the decision of Co-ordinate Bench of ITAT, Delhi in the case of Rockland Diagnostics Services Pvt. Ltd. v. ITO in ITA No. 316/Del/2019 dated 25.02.2021 wherein it was affirmed that "in absence of any specific inaccuracy or shortcoming in the DCF valuation method other than stating that year wise results as projected are not matching with the actual results declared in the final accounts, the AO cannot substitute his own valuation in place of the value determined either on DCF method or NAV method." He also placed reliance on the decision of Cinestaan Entertainment Pvt. Ltd. v. ITO in ITA No. 8113/Del/2018 dated 27.05.2019 wherein it

was held that the commercial wisdom of reputed investors should not be questioned by the AO without providing any tangible reasons.

14.5 On another aspect of date on which the valuation report was obtained as alleged by the Id. CIT(A), Id. Counsel submitted that even if the valuation report is obtained subsequent to the date of issue of shares, it does not alter the situation, rather what is relevant is whether Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 valuation report supports the share price determined by the assessee or not. For this contention, he placed reliance on the decision of Co-ordinate Bench, ITAT, Chennai in the case of Sri Sakthi Textiles Ltd. v. DCIT in ITA No. 1228/Chn/2019 dated 01.02.2021. In view of this decision by the Co-ordinate Bench of ITAT, Chennai, Id. Counsel submitted that observation of Id. CIT(A) that the valuation report obtained by the assessee is an afterthought is baseless and devoid of any merits.

15. Per contra, Id. CIT DR pointed out the discrepancies and observations made by the Id. CIT(A) while giving his findings, recorded in para 19 of the impugned order in respect of DCF method adopted by the assessee. He placed reliance on the findings given by the Id. CIT(A) who had confirmed the addition made by the Id. AO.

16. We have heard the rival contentions and given our thoughtful considerations made before us. We note that it is a trite law that "when a statute requires a thing to be done in a certain manner, it shall be done in that manner alone and not otherwise." This doctrine has been dealt in the case of CIT vs. SPL's Siddhartha Ltd. [2012] 17 taxmann.com 138 (Delhi).

16.1 Unlike explanation (a)(ii) to Section 56(2)(viib) where it has been specifically provided that valuation is to be substantiated to the satisfaction of the AO, there is no such provision specified in explanation (a)(i) of Section 56(2)(viib) as opted for by the assessee for substantiating its valuation to the satisfaction of the AO. Hence, on the facts of assessee's case, the AO was not empowered to disregard the DCF valuation as carried out by the valuer and such action of the authorities below of rejecting such valuation report and adopting the NAV method for the purpose of valuation and thereby making an addition u/s 56(2)(viib) of the Act cannot be upheld.

Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 16.2 Before examining the fairness or reasonableness of valuation report submitted by the assessee, we have to bear in mind that the DCF method is essentially based on projection (estimates) only and hence, this projection cannot be compared with the actual results 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 anybody's control.

16.3 In the present case before us, the assessee has placed the valuation report obtained by it from an independent Chartered Accountant which is placed at page no. 64 to 90 of the paper book, wherein the fair market value of equity share is arrived at Rs. 144.21 per share by taking the date of

valuation of 18.12.2012 in the report dated 29.12.2016 and in the another report where the date of valuation taken is 08.03.2013, the fair market value of equity share is arrived at Rs. 144.27 per share, date of valuation report being the same i.e. 29.12.2016.

16.4 We note that ld. CIT(A) has made certain observation while rejecting the valuation done by the assessee under DCF method by holding it as an afterthought and with a malafide intention. In the course of appellate proceeding, ld. CIT(A) asked for certain documents from the assessee including board resolution for the appointment of valuer, scope of valuation given, data provided to the valuer, valuation report and the bill issued by the valuer for the valuation charges. Further, ld. CIT(A) observed that in the year 2016 when the valuer was conducting valuation exercise, the valuer ought to have been aware about the financial statements of the assessee for the preceding years i.e. 2013-14, 2014-15 and 2015-16 which could have given indications for taking the realistic approach by taking into account the actual results of these past years. He also noted that the assessee did not submit the MIS data which was given to the valuer for the purpose of Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 valuation of shares and therefore, there is no possibility of verifying the correctness of the data supplied by the assessee to the valuer so as to ensure correctness and completeness of the valuation arrived at in the valuation report. Ld. CIT(A) thus, held that correctness of the result of DCF method could not be verified since the assessee could not conclusively established that the projections used for DCF valuation were prepared scientifically.

16.5 To arrive at the conclusion on the issue and give our finding, we note that Rule 11UA(2) gives an option to the assessee to opt and adopt either of the two methods prescribed therein, viz. (a) the NAV method or

(b) the DCF method. By taking guidance from the decision of Hon'ble High Court of Bombay in the case of Vodafone M-Pesa Ltd. (supra), we find that in the present case, ld. AO has no right to change the method of valuation adopted by the assessee who had opted for the DCF method for valuation of equity shares as ld. AO rejected the same and chose to take the NAV method. We, thus, hold that basis for valuation of equity shares in the present case has to be the DCF method opted by the assessee as prescribed under rule 11UA(2)(b) of the Rules.

16.6 We further note that the Coordinate Bench of ITAT, Bangalore in the case of Innoviti Payment Solutions Pvt. Ltd. v. ITO [ITS-4-ITAT-2019 (Bang.)] held that if the assessee has opted for DCF method, the AO cannot discard it and adopt another method, however, the AO is well within his rights to examine the methodology adopted by the assessee and the underlying assumptions and if he is not satisfied, he can challenge the same and suggest necessary modification. In the present case before us, as noted by the ld. CIT(A), assessee has not supplied the MIS data which was given to the valuer for the purpose of valuation of shares and also the details on the assumptions so as to conclusively establish that the projections used for DCF valuation were prepared scientifically. We find that it is imperative for the assessee to provide the Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 scientific basis for taking reliable estimates and projections, considering various economic factors, corroborating them supporting evidence for them.

16.7 In a nutshell, the Co-ordinate Bench of ITAT Bangalore in Innoviti Payment Solutions Pvt. Ltd. (supra), drew the conclusions in its para 14 which are reproduced as under:

(i) The AO can scrutinize the valuation report and that 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.

(ii) 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.

(iii) 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, terminal value, etc. with the help of empirical data or industry norms, if any, and/or scientific data, scientific method, scientific study and applicable guidelines regarding DCF Method of Valuation.

16.8 In the present case before us relating to the addition made towards share premium of Rs.2,47,18,166/- from 'Other Angel Investors' and of Rs.6,51,417/- from Aavishkar Ventures Management Services Pvt. Ltd. (AVMSPL) tabulated in Para 6 above, we hold that owing to the observations made by the Id. CIT(A) on the non-submission of MIS data and other details relevant to the valuation report placed on record, the above conclusions drawn by the Co-ordinate Bench of ITAT Bangalore in the case of Innoviti Payment Solutions Pvt. Ltd. (supra) apply mutatis mutandis and we direct, both, the assessee and the Id.

Milk Mantra Dairy (P) Ltd.

A.Y. 2013-14 AO to comply with the same, for which in the conspectus of factual matrix, applicable law deliberated above, we remit the issue of valuation of shares to the file of Id. AO for the limited purpose of verification in terms of conclusions noted above so as to arrive at satisfaction on the scientific basis of valuation and rationality of assumptions adopted to build hypothesis on the valuation of shares. The assessee is also directed to make available the MIS data and all the other details of various assumptions adopted to arrive at the given valuation of equity shares issued by it. Id. AO is also directed to analyze the data and projections which have undergone in arriving at the FMV on the basis of DCF method opted by the assessee and to come to a conclusion accordingly in terms of the applicable law. Before parting on this issue, we make it clear that we have not expressed any of our views on the correctness and completeness of the valuation report submitted by the assessee by adopting DCF method under Rule 11UA(2)(b) of the Rules so as not to impair or injure the verification process before the Id. AO. The observations made herein by us in remitting the matter back to the file of the Id. AO will also not impair or injure the case of the assessee and not

cause any prejudice to the defence/explanations of the revenue. Accordingly, these two grounds are allowed for statistical purposes.

17. In the result, the appeal of the assessee is partly allowed.

Order pronounced in the open court on 04.07.2022.

Sd/

(ABY T VARKEY)
JUDICIAL MEMBER

Kolkata, Dated: 04.07.2022

JD, Sr. P.S.

Sd/-

(GIRISH AGRAWAL)
ACCOUNTANT MEMBER

Milk Mantra Dairy (P) Ltd.
A.Y. 2013-14

Copy to:

1. The Appellant:
 2. The Respondent:
 3. The CIT, Kolkata
 4. The CIT (A) - , Kolkata
 5. The DR, ITAT, Kolkata Bench, Kolkata
- //True Copy// [

By Order

Assistant Registrar
ITAT, Kolkata Benches, Kolkata