

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 16th December, 2020

Pronounced on: 1st March, 2021

+ ITA 1007/2019& CM APPL. 54134/2019

PR. COMMISSIONER OF INCOME TAX-2 Appellant

Through: Mr. Ajit Sharma, Senior Standing
Counsel .

versus

M/S CINESTAAN ENTERTAINMENT PVT LTD Respondent

Through: Mr. Ajay Vohra, Senior Advocate
with Mr. Ashutosh Mohan Rastogi,
Mr. Dhruv Seth and Mr. Garvit
Gosain, Advocates.

CORAM:

HON'BLE MR. JUSTICE MANMOHAN

HON'BLE MR. JUSTICE SANJEEV NARULA

J U D G M E N T

SANJEEV NARULA, J.

1. The present appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') is directed against the order dated 27.05.2019 (hereinafter referred to as 'Impugned Order') passed by the Income Tax Appellate Tribunal (hereinafter referred to as 'ITAT') in ITA No. 8113/DEL/2018, for the Assessment Year 2015-16 (hereinafter referred to as 'AY').

2. The brief factual matrix giving rise to the present appeal is that M/s

Cinestaan Entertainment Pvt. Ltd.('Respondent-Assessee')was incorporated on 19.09.2013 and is engaged in the business of entertainment. During the concerned AY, the Respondent-Assessee allotted shares at a premium to various persons, as encapsulated in the assessment order. The Respondent-Assessee filed return of income for the relevant AY i.e., 2015-16 on 28.09.2015, declaring nil income. The return was processed under Section 143(1) of the Act. Thereafter, the case was selected for "Limited Scrutiny" and the reasons for scrutiny selection were (a) Large share premium received during the year [verify applicability of Section 56(2)(vii)(b)]; (b) Low income in comparison to very high investment; and (c) Low income in comparison to very high loans/advances/investments in shares.

3. Notice under Section 143(2) of the Act was issued on 07.04.2016 and was followed by a detailed questionnaire along with the notice under Section 142(1) on 12.10.2017. In response thereto, the Respondent-Assessee filed a valuation report dated 15.12.2014. Thereafter, vide order dated 31.12.2017, assessment was framed under Section 143(3) of the Act and the total income of the Respondent-Assessee was assessed as Rs. 90,95,46,200/-. The findings of the Assessing Officer ('AO') summarized by the Appellant are as follows:

"1. No effort was made by the assessee for achieving the projections made in the report as per Section 11UA. Hence the share premium received is without any substantial basis and is contrary to the provisions of Section 56(2)(viib) read with Section 2(24)(xvi), in view of the show cause notice discussed in the paragraphs below.

2. During the course of the assessment proceedings, a show cause notice vide letter dated 15.12.20 17 was issued fixing the case for

15.12.2017.

3. After taking comprehensive view of the submissions made by the AR pursuant to the Show Cause Notice, the following points emerge which are summarized as under-

i. On perusal of Balance Sheet as on 31.03.2015, it is seen that the assessee raised share capital and share premium during the year and invested the same in the following-

Sl. No.	Name of Company	Nature of Investment	Amount (Rs.)
1.	Script Stories Media P. Ltd.	Equity Share	26,000
2.	Script Stories Media P. Ltd	0% debenture	54,99,74,000
3.	Cinestaan Film Company P. Ltd. has become a subsidiary company wef 22.06.2015	0% debenture	30,00,00,000
4.	Script Stories Media P. Ltd. subsequently allotted on 06.05.2015	0% debenture application money	90,00,00,000

ii. It is clear that the assessee company has advanced share capital and share premium received during the year as per details given above, in debenture of associate companies on which no return will be in future, as the same is invested in 0% debenture. In order to achieve the revenue projected in the 11UA report, it is obvious that the investment should have been made to get

returns/income whereas the assessee has made investments in zero percent debentures in the aforementioned companies, hence the basic substance of receiving high premium is not justified. Hence the projection made to issue the shares on premium as per Rule 11UA report is not justified with the actual working of the company.

iii. Even when specifically asked, the AR submitted the basis for projections/ estimated figure but failed to provide any scientific basis for adopting those figures.

iv. On perusal of letter dated 26.12.2017, under Note 7 of Balance Sheet for the period ending 31st March 2017, it is seen that 0% unsecured compulsorily convertible debenture of Rs. 1000 each in M/s Script Stories Media P. Ltd. has been reduced to NIL as compared to Rs. 71,99,74,000/- in the preceding year. Further, it is seen that as per P&L account for the period ending 31st March 2017, assessee company has shown an amount of Rs. 71,99,40,002/- below the line in P&L A/c on account of loss on sale of investment in unsecured compulsorily convertible debenture of Rs. 1000 each in M/s Script Stories Media P. Ltd.

v. Since the investment was in zero percent debentures there was no scope of any income rather the transactions resulted in the loss of Rs. 71,99,40,002/-, it is clear that the assessee has made an investment with M/s Script Stories Media P. Ltd. without any interest to earn the income in future. Hence there was no effort on the part of the assessee to justify the projection made in the report under Rule 11 UA and premium as per Section 56(2)(viib).

vi. Ratio of share capital to share premium is 1:2602 by investors in assessee company, on the other hand during FY 2015-16 assessee is making investment in Cinestaan Film Company P. Ltd. of Re 1 share at a premium of Rs.4 approx. Ratio of share capital to share premium is 1:4, it is quite obvious that the investments made in share capital/share premium of M/s Cinestaan Film Company by the assessee cannot be held good in light of the fact that the share capital/share premium the assessee company received is in the ratio of 1:2602.

vii. On the basis of the figures derived from an analysis of the financial statement of assessee company for the AY 2016-17 and 2017-18, it is seen that the share premium is not justified. Even in 2017-18, the assessee company kept raising share capital on premium and at the same time booking losses on account of sale of zero percent debenture, in contradiction of each other. Hence the premium taken by the assessee is not justified even on merits.

4. In view of the above facts it is clear that the assessee company has failed to substantiate the premium of Rs.90,95,46,2011- received during the year. Hence the same is disallowed and added back to assessee's income.”

4. Aggrieved by the assessment order, the Respondent-Assessee preferred an appeal before the Commissioner of Appeals[CIT (A)], who upheld the additions made by the AO. The second appeal before the ITAT was allowed vide the impugned order and resultantly, the order of the CIT (A) has been set aside. The Appellant-Revenue now assails the aforementioned impugned order by way of the present appeal urging the following question of law:

“A. Whether. the Ld. ITAT has erred in law and on facts in deleting the addition made u/s 56(2)(vii)(b) of the Income Tax Act, 1961, by ignoring the sound reasoning and detailed analysis of the AO that the Cash Flow projections taken into account in the Discounted Cash Flow Method by the assessee are nothing but paper plans that have no relation with the reality?”

5. Mr. Ajit Sharma, learned Senior Standing Counsel for the Appellant-Revenue submitted that the learned ITAT has erred in deleting the additions made by the AO as confirmed by the CIT(A). He argued that the Respondent-Assessee was asked to submit the basis of projection/estimated figures as presented in the valuation report. However, no efforts were made to justify the projection made in the said report under Rule 11UA and for

premium as per Section 56(2)(viib) of the Act. Mr. Sharma further submitted that the CIT(A) had concluded that no independent enquiry was done by the valuer to verify the truth or the figures furnished by the Respondent-Assessee and that the valuation was based on assumption without independent verification of the truth/accuracy and completeness of the information and data provided by the company. He further argued that the AO had conducted a detailed analysis of allotment of shares at premium and further investment by the Respondent-Assessee and noted that the ratio of allotment of shares at premium is 1:2602, whereas further investment made by Respondent-Assessee is in the ratio of 1:4. Further, the Respondent-Assessee failed to submit the basis of projection/estimated figures as represented in the valuation report, thus, justifying the additions made. In this situation, the AO analysed the business profitability of the Respondent-Assessee only to the extent that such profitability was not commensurate with the actual financials provided by the Respondent-Assessee during the course of assessment proceedings. Therefore, the financials of the Respondent-Assessee did not support the business module of the company.

6. Mr. Sharma further submitted that while there cannot be any dispute on the fact that it is for the entrepreneur to visualize the business based on certain projections and to undertake all kind of risks, but in the case of the Respondent-Assessee, the valuation report projected profits, and whereas the financials represented losses, thereby demonstrating that the actual financials and the valuation report were completely contradictory to each other. He submitted that the learned ITAT had failed to consider that in

terms of Section 56(2)(viib), the Respondent-Assessee has to produce evidence to substantiate the basis of projections in cash flow and provide a reasonable nexus between such projections in cash flow with reality. He submitted that the learned ITAT ought to have considered that before accepting the Discounted Cash Flow method (DCF), it is important to bear in mind that the cash flow projection based on the projection of profitability should reasonably capture the growth prospects and earning capability of a company and that mere paper plans for expansion should not be taken into account. Unless the Respondent-Assessee provides the evidence justifying the facts and figures, it would not be possible either to accept the DCF method adopted by the Respondent-Assessee or to make suitable adjustment to the same for the correct determination of the share price. Lastly, he submitted that the assessment order framed by the AO and the order of the CIT(A) were based on sound reasoning, detailed analysis and therefore the conclusion drawn by them that the cash flow projection taken into account in DCF method was merely a paper plan having no connection to reality, is justified.

7. Per contra, Mr. Ajay Vohra, learned Senior Counsel for the Respondent-Assessee defended the impugned judgment and argued that no substantial question of law arises for consideration. Mr. Vohra submitted that it is the prerogative of assessee as to how much capital is to be raised based on its long-term and short-term funding requirements for the purpose of running its business. It was further submitted that Section 56(2)(viib) of the Act is not applicable to genuine business transactions and that the genuineness and creditworthiness of the strategic investors was not doubted by either the AO

or the CIT(A). Mr. Vohra submitted that sub clause (ii) of explanation to Section 56(2)(viib) is not applicable to the Respondent-Assessee's case and the assessee was not required to satisfy the Assessing Officer about the valuation done. In accordance with sub clause (i) of explanation, the Respondent-Assessee had an option to carry out a valuation and determine the fair market value (FMV) only on the discounted cash flow method (DCF), which was appropriately followed by the Respondent-Assessee.

8. We have heard and duly considered the arguments and contentions advanced by the learned counsel for both the parties.

9. In the present case, the Respondent-Assessee has received share premium from various subscribers/equity partners. These funds were required by the Respondent-Assessee for film production. The shares were issued based on the valuation received from the prescribed expert i.e., a Chartered Accountant who used the DCF method which is one of the methods stipulated under Section 56(2)(viib) read with Rule 11UA(2)(b). Based on the valuation report dated 15.12.2014, the Respondent-Assessee issued shares to various equity partners at a premium as per the following table:

S. No.	Name of equity partner	Date of Issue	No. of Shares	Premium (Rs.) per share	Amount of premium (Rs.)
1.	Shri Anand Mahindra	06.01.2015; 23.02.2015	4,15,385	1949	80,95,85,365 /-
2.	Shri Rakesh	24.03.2015	19,207	2602	4,99,80,793/-

	Jhunjhunwala				
3.	Shri Radhakishan Damani	24.03.2015	19,207	2602	4,99,80,793/-
	Total		4,53,799		90,95,46,200 /-

10. The AO has disregarded the valuation report of the Respondent-Assessee primarily on the ground that the projections of revenue as considered for the purpose of valuation do not match the actual revenues of subsequent years. The AO has made additions based on the assumption that the Respondent-Assessee made no efforts to achieve the projection as made out in the valuation report and therefore the share premium received by the Respondent-Assessee is without any basis and contrary to provisions of Section 56(2)(viib) read with Section 2(24)(xvi) of the Act. Further, the AO held that the Respondent-Assessee has failed to submit any basis of projection. He also held the view that in order to achieve the said projection, the Respondent-Assessee should have invested the share premium amount to earn certain income/return and whereas the Respondent-Assessee made investments in zero percent debentures of its associate company and therefore the basic substance of receiving a high premium is not justified.

11. We note that in the instant case, the AO had issued notice under Section 133(6) to all the investors to seek confirmation, information and documents pertaining to the issuance of shares. Further, the venture agreement between the Respondent-Assessee and the investors was also filed before the AO.

The learned ITAT thus, after due consideration of the record, concluded that neither the identity, nor the creditworthiness and genuineness of the investors and the pertinent transaction could be doubted. This fact stood fully established, before the AO and has not been disputed or doubted. Therefore, the nature and source of the credit stood accepted.

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 that Income Tax Department cannot

sit 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 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 Id. 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-TIOL-1358-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 along 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”.

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 Id. 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. 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.

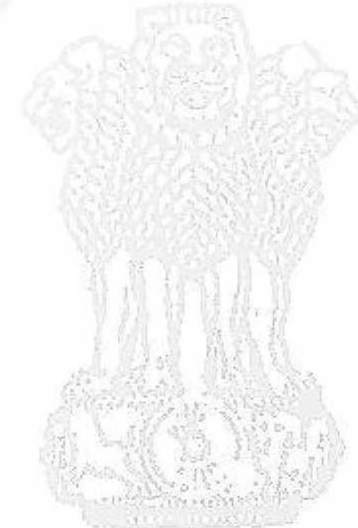
15. For the foregoing reasons, the appeal is dismissed along with pending application.

SANJEEV NARULA, J

MANMOHAN, J

MARCH 01, 2021

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