IN THE INCOME TAX APPELLATE TRIBUNAL
"A" BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT AND
SHRI B. R. BASKARAN, ACCOUNTANT MEMBER

ITA No.351/Bang/2019
Assessment Year : 2015-16

M/s. Medicon Leather Pvt. Ltd., 35/3, Hosur Main Road, Bommanahalli, Bengaluru – 560 068. **PAN : AABCM 3807 B**	Vs.	The Assistant Commissioner of Income Tax, Circle -4(1)(2), Bengaluru.
APPELLANT		RESPONDENT

Appellant by	:	Shri. Ashok A Kulkarni, Advocate
Respondent by	:	Shri. Sumer Singh Meena, CIT(DR)(OSD)(ITAT), Bengaluru

Date of hearing	:	25.11.2021
Date of Pronouncement	:	06.12.2021

O R D E R

Per N. V. Vasudevan, Vice President:

This is an appeal by the assessee against the order dated 31.12.2018 passed by the Pr.CIT, Bengaluru-4 u/s.263 of the Income Tax Act, 1961 (Act), relating to assessment year 2015-16.

2. The assessee is a company engaged in the business of manufacture of leather items. The assessee filed return of income for Assessment Year 2015-16 declaring a total loss of Rs.3,20,79,298/-. The case of the assessee was taken up for scrutiny assessment. The AO issued a notice under section 143(2) of the Act dated 20.09.2017 in which among other issues, the AO specifically called upon the assessee to show cause as to why income should

not be assessed under section 56(2)(viib) of the Act. Under the aforesaid provisions, if a company in which public are not substantially interested receives in any previous year from a person being a resident any consideration for issue of shares that exceeds the face value of such share, the aggregate consideration received for such share as exceeds the fair market value of the shares, shall be assessed as income under the head "income from other sources". During the previous year the assessee issued/allotted 560000 Equity shares at premium of Rs.50/- each. It is in this context that the AO called upon the assessee to show cause as to why the provisions of Sec.56(2)(viib) of the Act should not be applied.

3. In reply to the aforesaid notices, the assessee furnished a reply in which it submitted that Reserve Bank of India has Vide notification issued in 2014 stipulated that the price of shares issued should not be less than fair value as per internationally accepted pricing methodology. Based on the Accounting standard under IFRS 13, the fair value has to be based on the most appropriate method, for example on Market Based Approach or Income Based Approach or a combination of these. The assessee submitted that premium was calculated as per valuation standards keeping in view the intrinsic value, goodwill, future prospects and other factors. The amount of share application money has thus been worked out and premium charged. The assessee pointed out that as per sec 56(2)(Vllb), the premium becomes taxable only if the valuation is not substantiated by us. As explained above the premium was fixed keeping in view the intrinsic value of share, the past performance of the company and future prospects. The intrinsic value of share as at 31/03/2014 itself was around Rs.45/- per share. The assessee

therefore submitted that the valuation has been properly arrived at as per guidelines given be SEBI and Reserve Bank of India and is fair.

4. The AO thereafter issued another notice dated 07.12.2017 specifically calling upon for explanation as to why a sum of Rs.4,12,85,817/- should not be brought to tax under section 56(2)(viib) of the Act. The assessee in the reply filed before the AO on 13.12.2017 submitted that the share value as per the net assets value method is Rs.66/- and not Rs.22/- as arrived at by the AO in his notice dated 07.12.2017. Thereafter, the AO passed an order under section 143(3) of the Act in which he did not make any reference whatsoever to the notice and replies of the assessee but accepted the loss as return by the assessee in the order passed under section 143(3) of the Act, dated 21.12.2017.

5. The Principal CIT, in exercise of powers of revision under section 263 of the Act, issued a show cause notice to the assessee. In the show cause notice, the Pr. CIT observed as follows:

> "a. On perusal of assessment records it is noticed that the company has allotted 5,60,000 shares of Rs.10 each with a premium of Rs.50 per share to Sri. Sangieve S Bulchandani and collected share capital of Rs.56,00,000 and share premium of Rs.2,80,00,000 by adjusting share application money of earlier year. The Company has not filed any share valuation certificate. The value of share works out to Rs.42.60 as per rule 1 I UA . Thus the company collected excess share premium of Rs.17.40 per share amounting to Rs. 97,44,000, which is taxable 11/s 56(2)(viib) of the Act.
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> b. Further the assessee has received share application money of Rs. 5.09.88.568 from Sri. Sangieve S Bulchandani and the sources of investment have not been verified by the AO.

> The AO has failed to conduct enquiries regarding the above issues and has failed to bring to tax the correct amount while completing the assessment Liis 143(3). Therefore. action u/s.263 is warranted and the assessment for the AY 2015-16 was proposed to be revised accordingly."

6. In reply to the aforesaid show cause notice, the assessee filed submissions dated 27.12.2018 taking a stand that the AO conducted due enquiries before concluding the assessment. The assessee also submitted that it filed valuation report in accordance with Rule 11UA of the Rules and arrived at a value of Rs.68/- per share whereas the assessee had issued only at Rs.60/-. The assessee therefore claimed that there was no case for invoking the provisions of section 56(2)(viib) of the Act. The CIT(A) however did not accept the claim of the assessee and she held that the order of the AO was erroneous and prejudicial to the interest of the Revenue for the following reasons:

a) The value of shares as per NAV method was Rs.42.60/-.
b) Assessee did not give any valuation report as required under Rule 11UA of the Rules.
c) As per Rule 11UA, the assessee only has 2 options for working out FMV of unquoted shares viz., NAV method or discounted cash flow method. Since the assessee did not furnish any valuation report as per DCF method, fair market value should have been adopted as per NAV method.
d) The action of the AO in accepting the method of valuation contrary to Rule 11UA of the Rules was erroneous and prejudicial to the interest of the Revenue.

The CIT therefore held that there was no application of mind by the AO and the AO has accepted the version of the assessee in mechanical manner. The CIT according set aside the order of the AO with the following observations to be redone by the AO afresh in accordance with law, with the following observations:

> "4. The written submissions made by the assessee are carefully examined in the light of fact of the case, material paced on record and the provisions of sec. 263 of the Act. The fair market value of shares can be book value or value as per discounted cash flow method. The value of shares as per NAV method works out to Rs.42.60 and the assessee has not furnished any valuation report as required u/r 11UA. The assessee in its submissions stated that the fixed assets were got valued by Registered Valuers as required under company law and the intrinsic value of the equity shares was much higher at the end of the F.Y.2014-I 5. Ihe submissions of the assessee are not tenable as the assessee is having only two options for working out the fair market value of unquoted shares as per Rule 11 UA of Income tax Rules. 1962 i.e. NAV method and the other one is discounted free cash flow method. Since the assessee has not furnished any valuation report as per DCF method fair market value has to be adopted as per NAV method. The AO has failed to make proper enquiry, examination and verification as warranted for proper completion of assessment, with respect to claim of assessee made towards share premium and also sources for the share application money. The AO has accepted the claim of the assessee without conducting any enquiries, verification or examination of the issue r the present case, as evident from the record, the claim of the assessee has been accepted by the Assessing Officer in a mechanical manner. It is incumbent on the AO to make requisite verification before allowing a claim made by the assessee. The AO cannot remain passive when the issues in the return of income provoke further inquiries. Thus, the assessment in question was made without making proper inquiries or verification which should have been made on the facts of the case.
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> 5. On the facts of the case it appears that no enquiry was conducted by the AO which renders the order erroneous and prejudicial to the interest of revenue. It can only be concluded that

there was non application of mind by the AO and hence proceedings u/s 263 o le 1961 Act are warranted.

6. From the foregoing discussion, it is manifestly clear that the assessment order dated 21.12.2017 passed by the Assessing Officer in the case of the assessee for A.Y. 2015-16 is not only erroneous but also prejudicial to the interests of revenue and the twin conditions as contemplated in sec. 263 are, satisfied in the present case. Consequently, **the assessment is set aside to the file of the AO with a direction to the Assessing Officer to examine the aforesaid issues and redo the assessment afresh as per law after affording reasonable opportunity of being heard to the assessee."**

7. Aggrieved by the order of the CIT, assessee is in appeal before the Tribunal. Learned Counsel for the assessee submitted that the AO made the requisite enquiries before concluding the assessment. We have already referred to the enquiries made by the AO in the earlier part of the order and we therefore do not wish to elaborate on these aspects. The submissions of the learned Counsel for the assessee was that explanation to section 56(2)(viib) of the Act defines fair market value as follows:

> ***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";***
> *(emphasis supplied)*

It was submitted that fair market value of the shares may be computed as under:

a. Value determined in accordance with the prescribed under Rule 11UA read with Rule 11U of the IT Rules, 1962.

(Or)

b. 'Intrinsic Value'

It was submitted that as per Rule 11UA(2), the fair market value of unquoted equity shares for the purposes Clause (a)(i) of Explanation to Section 56(2)(viib) of the Act shall be the value as determined in the following manner under clause (a) or clause (b), at the option of the assessee, namely:—

(a) value determined as per the formula [(A—L) x (PV)]/ (PE) **('Formula')**
(b) value determined by a merchant banker as per the Discounted Free Cash Flow method **('DCF')**

It was submitted that the CIT the valuation should be undertaken in accordance with Rule 11 UA alone and in the absence of a valuation report under Discounted Cash Flow method cannot be substantiated is misplaced and bad in law. It was submitted that the Assessee had adopted the intrinsic value method as permitted under Sec.56(2)(viib) (a)(ii) of the Act and this has been overlooked by the Prl.CIT. and that she failed to demonstrate how the Intrinsic value method of valuation adopted by the Assessee was erroneous and prejudicial to the interests of the Revenue. It was submitted that where two methods for computation of Fair Market Value of the shares are provided under the statute, and the Assessing Officer adopts one method, the view taken by the Assessing Officer cannot justify interference by the Commissioner u/s 263 of the IT Act. The learned counsel of the Assessee relied on the following decisions:

- **Malabar Industries Vs. CIT** reported in **243 ITR 83 (SC)**
- **CIT Vs. Gokaldas Exports** reported in **333 ITR 214 (Kar)**

8. Without prejudice to the above submissions, it was submitted that Section 56(2)(viib) of the Act stipulates that receipt of consideration in the previous year is necessary to attract those provisions and that in the present

case the consideration for the issue of shares was received in the year ending on 31.03.2014 (relevant to AY 2014-15 and not AY 2015-16. The learned DR relied on the order of the CIT.

9. We have carefully considered the submissions of the learned Counsel for the assessee. It is no doubt true that as per explanation to section 56(2)(viib) of the Act apart from the determination of FMV of shares under Rule 11UA of the Rules, intrinsic value is also one of the methods prescribed method as per Sec.56(2)(viib) (a)(ii) of the Act, but the higher of the valuation as per Sec.56(2)(viib)(a) (i) or (ii) has to be considered by the AO before applying those provisions. The admitted position in the present case is that the assessee did not file any valuation report to substantiate the fair market value of shares issued in terms of Sec.56(2)(viib) (a)(i) of the Act and Rule 11UA of the Rules. In such circumstances, we are of the view that the AO could not have accepted the intrinsic value without calling for a value in terms of Rule 11UA of the Rules to find out whether class (i) or class (ii) of explanation (a) to Sec.56(2)(viib) of the Act would be applicable. In this view of the matter, we are of the view that the order of the AO was erroneous. With regard to the argument that the money was received in the previous year relevant to Assessment Year 2014-15 and therefore the provisions of section 26(2)(viib) of the Act were not application to Assessment Year 2015-16, the admitted position is that the shares were issued in Assessment Year 2015-16 and this would be the appropriate year in which the applicability of provisions of section 56(2)(vii) of the Act should be considered. In this regard, we place reliance on the decision of ITAT, Bengaluru Bench in the case of M/S. Taaq Music Private Limited, Vs Income Tax Officer ITA No.161/Bang/2020, order

dated 28 September, 2020 in which the view as stated above was laid down by the Tribunal. We, therefore, find no merit in the appeal by the assessee. We, however, make it clear that all aspects with regard to applicability of the provisions of section 56(2)(viib) of the Act are left open in the proceedings before the AO who shall examine the same uninfluenced by observations made either in this order or in the impugned order of the CIT. With these observations, we dismiss the appeal of the Assessee.

10. In the result, appeal of the assessee is dismissed.

Pronounced in the open court on the date mentioned on the caption page.

Sd/-	Sd/-
(B. R. BASKARAN)	**(N. V. VASUDEVAN)**
ACCOUNTANT MEMBER	**VICE PRESIDENT**

Bangalore,
Dated : 06.12.2021.
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Copy to:

1. Appellant 2. Respondent 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.