IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "H", MUMBAI

Before Shri Rajesh Kumar, Accountant Member
& Shri Amarjit Singh, Judicial Member

ITA No.3955/Mum/2018
Assessment Year: 2014-15

Karmic Labs Pvt.Ltd. B-1, 2302, The address, Opposite R-City Mall, LBS Marg Ghatkopar(West) Mumbai-400 086 PAN: AACCK7809G	Vs.	ITO,Ward-15(2)(1) Aaykar Bhawan M.K.Road Mumbai-400 020
(Assessee)		(Revenue)

Revenue By : Shri R.Bhupathi
Assessee By : Shri Ketan Ved

Date of Hearing : 10/07/2020		**Date of Pronouncement : 28 /07/2020**

O R D E R

Per Rajesh Kumar, Accountant Member

1. The Assessee by way of this appeal is challenging the order of the Ld. Commissioner of Income-Tax (Appeals)-24 hereinafter called [CIT(A)], Mumbai, in Appeal No.CIT(A)-24/ITO-15(2)(1)I.T 349/2016-17 dated 28/03/2018. The assessment for impugned AY was framed by Income Tax Officer Ward-15(2)(1), Mumbai [AO] u/s 143(3) of the Income Tax Act,1961 on 30/03/2015. The various grounds raised by the assessee are reproduced as under:

> ***1.0 Re.: Considering the premium of Rs. 3,96,54,531/- received from shareholders via-a-vis issue of equity shares and preference shares as income u/s. 56(2)(viib) of the Income-tax Act, 1961:***

https://itatonline.org

1.1 The Commissioner of Income-tax (Appeals) has erred in confirming the action of the Assessing Officer of considering the share premium received from the shareholders on issue of equity shares and preference shares as income for the year under consideration u/s. 56(2)(viib) of the Income-tax Act, 1961.

The Appellant submits that considering the facts and circumstances of its case and the law prevailing on the subject, the premium on issue of equity shares and preference shares cannot be considered as income and the Commissioner of Income tax (Appeals) ought to have held as such.

1.3 The Appellant submits that the Assessing Officer be directed to delete the addition so made by him and to re-compute its total income accordingly.

2 : 0 Re.: General:

2 : 1 The Appellant craves leave to add, alter, amend, substitute and / or modify in any manner whatsoever all or any of the foregoing grounds of appeal at or before the hearing of the appeal.

2. The only issue raised by the assessee is against the confirmation of addition by Ld.CIT(A) as made by the Ld. AO u/s 56(2)(viib) of the Act.

3. The facts in brief are that the assessee filed a return of income on 29/09/2014 at 'Nil'. The case of the assessee was selected under CASS for scrutiny and accordingly statutory notices were issued and served upon the assessee. The assessee is a registered company under the Companies Act and is engaged in the business of providing Clinical Testing, Clinical Trial Management, Clinical Data Management, Bio Statistics and Medical Writing services to Pharmaceutical & Medical Device companies. During the course of assessment proceedings, the Ld. AO observed that during the year, the assessee has issued equity shares, as well as preference at a premium as per details below:

https://itatonline.org

Sl. No.	Date	No. of shares	Face value	Premium Rate	Nature of allotment
1	18.10.2013	8024	10/-	@ 1987/-	Preferential allotment
2	18.10.2013	340	10	1987/-	Equity
3	25.02.2014	18	10 / -	1987/-	Equity
4	28.02.2014	8806	10/-	26S9/-	Equity

and accordingly, the Ld. AO called upon the assessee to furnish the basis of valuation for issuing the shares at a premium, which was replied by the assessee by submitting that section 56 of the I.T Act r.w.s. Rule 11UA provides for the valuation of shares and according to the company has valued its shares as per discounted Free Cash Flow Method. The said method uses the future free cash flow projections and discounts them and thus filed the valuation report before the Ld. AO. On perusal of projection of the growth of the assessee, the Ld. AO observed that the projections did not reflect that the true and realistic figure, as the projections made were neither comparable with the growth of the company in the past nor in the subsequent year. The Ld. AO noted that AY 2015-16 & 2016-17 returns filed by the assessee reveal that the assessee has failed to achieve the revenue projections and so the EBITDA. Moreover, the assessee has also failed to bring on record, the basis wherein two different projections were given by it in the same financial year. The Ld. AO noted that as per the assessee's valuation, the assessee has

https://itatonline.org

valued share price at a premium of Rs.1987/- on 25/02/2014 and Rs. 2689/- on 28/02/2014, just three days after, the date of the earlier issue of shares. No evidence were produced on record to explain the hike over the three days and accordingly issued a show cause notice to the assessee as to why the provisions of Rule 11UA(2)(a) should not be adopted for calculating the market value in the shares as on the date of issue of premium, which was responded by the Ld. AR, vide letter dated 16/12/2016, which was rejected by the Ld. AO thereby rejecting the valuation of discounted cash flow method calculated by the assessee stating the same of having unrealistic results and calculated the valuation of share as per provisions of Rule 11UA(2)(a). The ld. AO observed that since, the liabilities exceeds the assets of the company as calculated in para 5.8 of the assessment order, the fair market value of the shares is negative and hence, the market value is taken at face value of Rs.10/- each and accordingly, the share premium received of Rs. 3,96,54,531/- was added back to the total income of the assessee u/s 56(2)(viib) of the I.T.Act.

4. In the appellate proceedings, the Ld. CIT(A) dismissed appeal of the assessee by observing and holding as under:-

> *4. I have given my careful consideration to the rival submissions, perused the material on record and duly considered the factual matrix of the case as also the applicable legal position.*
>
> ***Ground No. 2***
>
> *4.1 In this ground, the appellant has challenged the addition of Rs. 3,96,54,531 u/s.56(2)(viib) of the Act by the AO on account of issuance of*

https://itatonline.org

shares o basis of Discounted Free Cash Flow Method instead of Net asset method.
Section 56(2)(viib) of the Act states –

"(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:—
(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".

appellant has carried out the valuation of shares under the Discounted Free cash flow method which uses the future projections of financial growth to arrive at the FMV of shares. After perusing the return of income of the appellant for AY 2015-16 & 2016-17 it is evident that the projections estimated by the appellant are not achieved. Further, the appellant has valued the premium price of shares at R/1,987 oh 25.02.2014 and Rs^2,68S on 28.02.2014 while it has failed to provide any evidences to prove this hike in the projection of the share
prices.

The appellant, in its submissions has made a reference to the Supreme court's decision in the case of Swasthya Adhikar Manch, Indore & ANR. v/s Union of India & ORS. wherein the Supreme Court asked the government to provide more details on the mechanism adopted to approve the clinical / drug trials. In spite of this order having a negative impact on the companies in the business of clinical trial management, the appellant has projected higher growth. Further, when the second round of shares were issued by the assesse the Supreme court had already come up with its observations which were against the appellant as per his own submissions and still the said shares were issued at a higher premium. The submissions also suggest that the appellant's projections do not match with the past growth as well as the future projected growth for AY 2015-16 & 2016-17.

The AO is accurate in calculating the FMV of shares as per the provisions of Rule 11UA(2)(a) and disregarding the appellant's calculation as per the Discounted Free Cash Flow Method

In view of the above, it has to be held that the AO is right in adding the entire premium of Rs. 3,96,54,531 to the total income of the appellant u/s 56(2)(viib) of the Act. This ground of appeal is dismissed.

5. The Ld. AR, at the outset submitted for bench that the assessee has followed discounted cash flow method, which was

one of the two methods provided u/s 56(2) of the Act r.w. Rule 11UA of the Act. The Ld. AR submitted that the assessee determined the market value of the shares on the basis of orders book, which were either finalized or were at the final stage of the negotiations. The total order value of orders in hands were Rs. 18.01 crores based on the said orders book. The assessee has estimated the future cash flow and also submitted the orders book along with advance received from various clients. The Ld. AR prayed before the bench that the valuation, as per the DCF method requires revenue projections for the future years which is based on the current situation and the future estimates, which were based upon present circumstances and facts such as orders book and accordingly, the Ld. AR submitted that the assessee has a valid basis for the revenue forecasts and if due certain subsequent happenings and unavoidable circumstances, the projections were not achieved, the same cannot be attributable to the assessee. The Ld. AR, therefore stated that it is wrong on the part of the Ld. AO to reject the valuation done by the assessee, as per DCF method and prayed for the bench that additions made may kindly be deleted. The Ld. AR relied on the following the decision in defence of the arguments i.e i) Vodafone M-Pesa Ltd. Vs PCIT [2018] 92 taxmann.com 73 (Bombay) ii) DCIT vs Ozoneland Agro Pvt.Ltd ITA No.4854/Mum/2016 AY 2013-14 dated 02/05/2018 and Vodafone M-Pesa Ltd vs DCIT [2020] 114 taxmann.com 323 (Mumbai-Trib.) order dated 13/12/2019. The Ld. AR submitted that in all these above decisions, it has been held that the Ld. AO is not at liberty to change the method adopted by the assessee at his whims and

https://itatonline.org

fancies and is bound by the valuation done by the assessee , as per by the method prescribed under Rule 11UA of the Rules and thus, the prayed before the bench that appeal of the assessee may be allowed.

6. The Ld. DR, on the other hand relied on the order of the authorities below by submitting that the valuation done by the assessee, as per the DCF method was too distant from reality as in the subsequent returns filed by the assessee, the projections were not achieved and thus, the valuation of the assessee was not correct and therefore, rightly rejected by the Ld. AO and therefore, prayed that the appeal of the assessee may be dismissed.

7. After hearing both the parties and perusing the material available on record, we note that the assessee has issued shares at a premium. In order to ascertain the market value of the shares, the assessee adopted DCF method, as prescribed under Rule 11UA r.w.s 56(2) of the Act and accordingly, the shares were issued at a premium. According to the Ld. AO, the valuation report furnished by the assessee is not realistic as the projections shown by the assessee in the valuation report were not realistic and were not achieved in actuality in the subsequent years. Whereas on the other hand the assessee has tried to justify the valuation with reference to orders book of Rs.18.01 crores. Therefore, only issue before us, whether the Ld. AO has the power to change the method adopted by the assessee from one method to another method provided under Rule 11UA. We have perused the decisions relied upon by the assessee and are of the

https://itatonline.org

considered view that the issue is settled in the following cases, where it has been held that it is beyond the jurisdiction of the AO to change the method of valuation. In the case of DCIT vs M/s Ozoneland Agro Pvt.Ltd. The Tribunal has held as under:-

> ***5.1.*** *In our opinion, the valuation has been left to the discretion of the assessee. In other words the AO cannot adopt a method of his choice. In the case under consideration the whole controversy has arisen because of the AO has rejected the method adopted by the assessee.*
> *We find that in the case of Medplus Health Services P.Ltd.(supra)similar issue was deliberated upon and decided. We are reproducing the relevant portion of the order which reads as under:*
>
> *"3.During the assessment proceedings u/s 143(3) of the Act, AO observed that the assessee company is a wholesale supplier of goods mainly to its group company M/s. Optival Health Solutions P. Ltd., which in turn is engaged in retail business of pharmaceuticals and general goods and further that both the companies have more than 67% common shareholdings. It was observed that during the F.Y. 2010-11, a major restructuring of the group had taken place wherein almost all the shares of M/s. Optival Health Solutions P. Ltd., were taken-over by the assessee company and the wholesale operations from the assessee were taken-over by M/s. Optival Health Solutions P. Ltd., resulting in the assessee company becoming the holding company of M/s. Optival Health Solutions P. Ltd., and both the wholesale and retail operations coming under the assessee company indirectly. He further observed that majority of the small shareholders of M/s. Medplus Health Care P. Ltd., transferred their shares to Mr. G. Madhukar Reddy, promoter and one of the major shareholders of assessee company and Mr. Madhukar Reddy along with other major shareholders transferred their majority of shareholdings at an attractive price to some local and international institutional investors. Out of these transactions, the A.O. observed that two persons i.e., Mr. C. Srinivasa Raju and Chintalapati Holdings P. Ltd., transferred their shares to the assessee on 04.03.2011 at Rs.75.49 per share whereas, on the same day and also on 08.03.2011 all the other shareholders transferred their shareholdings to the assessee at Re.1 per*

share. He observed that when the market rate is Rs.75.49 ps, the assessee has purchased the shares at less than the market price i.e., Re.1 per share and therefore, the transactions attract provisions of section 56(2)(viia) of the I.T. Act. Therefore, the A.O. issued a show cause notice dated 27.02.2014 requiring the assessee to explain as to why the difference amount of Rs.74 per share should not be treated as a deemed gift/income and taxed in the hands of the company. The assessee, vide letter dated 07.03.2014, submitted a detailed note as to why the provisions of section 56(2)(viia) are not applicable to the assessee's case. It was submitted that as per Explanation to Section 56(2)(viia) of the Act, the 'fair market value' (FMV in short) has to be computed in accordance with Rule 11UA of I.T. Rules and that the assessee had computed the fair market value as per the prescribed rule according to which, the fair market value of the share is less than Re. zero and hence, payment of Re.1 per share by the assessee to acquire the shares is more than the fair market value computed under Rule 11UA. Thus, according to him, the provisions of section 56(2)(viia) of the Act do not apply. The A.O. however, was not convinced with the assessee's contentions and held that the 'market value' mentioned in the rule means "price which it would have fetched if sold in the open market."

He observed that the valuation of any property is based on the fact as to what value the property would fetch if sold in the open market and since in the assessee's own case there are certain transactions to clearly establish market value of the shares sold, resorting to estimation/calculation of market value of the unlisted shares as per the formula under Rule 11UA of I.T. Rules does not arise. He observed that as per the computation of fair market value under Rule 11UA(c)(b) of I.T. Rules, the value of M/s. Optival Health Solutions P. Ltd., was (-) Rs.64.48 ps (i.e., the value of M/s. Optival share is at negative figure) whereas, assessee has paid Re.1 per share and the basis for adopting Re.1 per share by the assessee is not provided. He further observed that one of the shareholders Mr. Kalyana Bhaskara sold his shares in Optival to Mr. Madhukar Reddy at Rs.63.79 ps per share and the basis for adopting this rate is also not known but since it was much more than what is claimed by the assessee at Re.1 per share, he held that it was so shown to defraud the Revenue by transacting at abnormally low price. He therefore, held that the provision of deemed gift under section 56(2)(viia) of the I.T. Act is applicable. Thus, he adopted the price of Rs.75.49 ps paid to unrelated parties to be the market price of the unquoted shares of the company M/s. Optival Health Solutions P. Ltd., and the difference of Rs.74.49 ps per share was treated as

https://itatonline.org

"Income from other sources" in the hands of the company. Further, vide its letter dated 19.03.2014, the assessee submitted that as on 3rd March, 2011, the total value of equity shares of M/s. Optival Health Solutions P. Ltd., was Rs.45,44,740, out of which, the shares of Rs.15,90,000 were partly paid i.e., only up to Rs.0.50 ps and that these partly paid up shares were also acquired by the company from the shareholders. It was submitted that in the case of partly paid up shares, an amount of Rs.9.50ps is still to be paid by the purchaser and hence, the value of deemed gift in the case of partly paid shares is to be calculated accordingly. After considering the assessee's contentions, the A.O. computed the value of the deemed gift of partly paid up shares at Rs.10,33,34,100 and of fully paid up shares at Rs.10,89,39,465 and brought it to tax. Aggrieved, assessee preferred an appeal before the Ld. CIT(A) who confirmed the order of the A.O. and against the order of the Ld. CIT(A), the assessee is in second appeal before us.

4. The Ld. Counsel for the assessee, Mr. Kanchan Kaushal, while reiterating the submissions made by the assessee before the authorities below, drew our attention to the provisions of section 56(2)(viia) of the I.T. Act, to demonstrate that the said provisions would apply to the assessee only if the price paid by the assessee was less than the fair market value computed under Rule 11UA of I.T. Rules. He submitted that where the legislature prescribes a particular method to be adopted, then the said method alone should be adopted. He has submitted that in the case of assessee before us, neither the provisions of section 56(2)(viia) nor the Rules prescribe for adoption of the market value of the shares as the fair market value for the purpose of deemed gift under section 56(2)(viia) of the I.T. Act since the provisions relates to anti-abuse provisions. He submitted that where a specific method is prescribed, the A.O. is precluded from adopting any other method. He further drew our attention to the decision of Hon'ble Allahabad High Court in the case of Dr. Shashi Kant Garg v. CIT [2006] 285 ITR 158/ 152 Taxman 308 in support of his contention that a prescribed method has to be strictly followed. He has also placed reliance upon the following other judgments in support of his contention :

xxxx

5. The Ld. D.R. on the other hand, supported the orders of the authorities below and submitted that where the market price of the shares at which the assessee has purchased the shares on the very same day is available, the A.O. has rightly adopted the same instead of resorting to the valuation of the fair market value of the shares under Rule 11UA of the I.T. Act. Thus, according to him, the assessment order is to be upheld.

https://itatonline.org

6. Having regard to the rival contentions and the material on record, we find that ground No.1 is general in nature and hence needs no adjudication. With regard to ground No. 2, we find that though the assessee has raised this ground of appeal before the Ld. CIT(A), it was rejected on the ground that the assessee did not press the said ground of appeal. Even before us, the assessee did not advance any arguments on this issue at the time of hearing. In view of the same, ground No. 2 of the assessee is not adjudicated and treated as rejected.

7.As regards grounds No. 3 to 5 are concerned, we find that the undisputed facts are that the assessee has purchased the shares of M/s. Optival Health Solutions P. Ltd., at Re.1 on 4/3/2011 and 8/3/2011 while some of the shareholders have sold the shares of the very same company to the assessee on the very same day at Rs. 75.49 per share. It is also not disputed that the assessee company and M/s. Optival Health Solutions P. Ltd., are related to each other. The only dispute is whether the provisions of section 56(2)(viia) of the I.T. Act are applicable to the facts of the case before us. For the sake of convenience and ready reference, the relevant provisions are reproduced hereunder :

Explanation. For the purposes of this clause, "fair market value" of a property, being shares of a company not being a company in which the public are substantially interested, shall have the meaning assigned to it in the Explanation to clause (vii);]'

7.1 Further, the Explanation to clause (vii) to 56(2) of the Act reads as under :
EXPLANATION:

'(b) "fair market value" of a property other than an immovable property, means the value determined in accordance with the method as may be prescribed.'

7.2 The prescribed method for valuation of the fair market value is under Rules 11U and 11UA(c)(b) of I.T. Rules. Rule 11UA (c)(b) reads as under :

7.3 From the literal reading of the above provision, it is clear that to apply the above provision, the following conditions have to be satisfied:

i. there is transfer of shares a company not being a company in which the public are substantially interested:

ii. the purchaser of the shares is a company not being a company in which the public are substantially interested;

iii. the consideration is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees; and

iv. the deemed income in the hands of the transferee shall be the aggregate fair market value of such property as exceeds such consideration.

8. From the facts of the case before us, it is seen that the property i.e., shares which are transferred are the shares of a company in which the public are not substantially interested.

Since the transaction of sale and purchase of shares is between related parties and both the companies are companies in which the public are not substantially interested, we are of the opinion that the AO was justified in examining the applicability of the provisions of section 56(2)(viia) of the Act to the transaction of transfer of shares.

9. The next step for application of this provision is to arrive at the fair market value of the shares before comparing it with the consideration at which the shares are purchased by the assessee to examine if it was less than the aggregate fair market value of the property exceeding Rs. 50,000.

In the case before us, the AO had adopted the price at which the assessee has purchased the shares from two of the shareholders at a higher price of Rs. 75.49 ps as the fair market value of the share. The question before us is, whether this is valid and as prescribed under the Act? Clause (b) of the explanation to clause (vii) to section 56(2) defines 'fair market value' to be the value as computed under the prescribed rule i.e., rule 11UA. According to the ld counsel for the assessee, where the Act prescribes a rule, it has to be strictly and mandatorily followed and further if the statute has conferred a power to do an act and has laid down the method in which that power is to be exercised, it necessarily prohibits the doing of the act in any other manner than that has been prescribed.

In support of this contention, the assessee has relied upon various decisions cited supra. Let us now examine the applicability of the said decisions to the facts of the case before us.

xxxx

Though the facts and circumstances under which the above rulings have been given are distinguishable, we find that the legal principles laid down in the above judgments are clearly applicable to the facts of the case before us. Therefore the question before us is whether the A.O. can adopt the value at which the assessee acquires the shares of the same company on the same day for a higher consideration as the fair market value of the shares or whether FMV is compulsorily to be valued under Rule 11UA of the Act before applying the provisions of Sec. 56(2)(viia) of the Act.

10. From a plain reading of the provisions which are reproduced above and also the precedents discussed above, it is seen that section 56(2)(viia) requires that before application of the said provision, the A.O. has to

necessarily compute the fair market value and only then can compare the same with the consideration paid by the assessee and apply the said provision only if the conditions set therein are satisfied. In the case before us, undisputedly some of the shareholders have sold the shares at a much higher price than that at which the assessee has purchased the balance of the shares from other shareholders i.e., at Re.1. Though the A.O. has not computed the fair market value in accordance with Rule 11UA of the I.T. Rules, he had evidence before him to be satisfied that the market value of the shares was much higher than the value at which the balance of shares were transferred to the assessee. The AO has observed that "mainly the valuation of any property is based on fact as to what value the property would fetch if sold in open market but generally the details as to how much value an unlisted share would fetch will not be available and hence the formula is given to overcome that deficiency". Since the market price of some of the shares at a higher value than Re.1 was available, the AO has adopted the same as the fair market value. This stand of the AO could have been sustainable had the section provided that the FMV of an unquoted share shall be the value computed in accordance with the rule or the actual market value, if any, whichever is higher. But as can be seen from the Act and the rules provided there under, no such provision has been made. In fact, under the Wealth Tax Act, Section 7(1) defines the expression "value of an asset" as "the price which in the opinion of the WTO it would fetch if sold in the open market on the valuation date" but in the relevant provisions the definition of fair market value is given in the Act and method has also been prescribed thereunder.

11. On a careful reading of the judgments discussed above, it is seen that the Courts have held that where a method has been prescribed by the legislature, that method alone shall be followed for computation of the fair market value. The A.O. and the Ld. CIT(A) have not followed the relevant provisions for adopting or computing the fair market value of the shares, but have adopted the market value at which some of the shares have been purchased by the assessee as FMV. This, in our opinion, is not correct. As held by the Courts in the above judgments, the A.O. has to compute the fair market value in accordance with the prescribed method but cannot adopt the market value as fair market value under section 56(2)(viia) of the Act. The legislature in its wisdom has also given a formulae for computation of the fair market value which cannot be ignored by the authorities below.

12. We find that at para 4.12 of the assessment order, the AO has recorded that the assessee has furnished the valuation of the shares based on the

https://itatonline.org

working given under rule 11UA(c)(b) of the IT Rules, according to which, the fair market value of the shares is Rs. 64.48/- (i.e., the value of Optival share is at a negative figure) whereas the assessee has paid at Re.1 per share. He has also observed that no basis is given by the assessee for adopting the rate of Rs.63.79 per share for purchase of shares by Sri Madhukar Reddy. He observed that there is no basis for transacting in the shares at different rates and that this arrangement has been done to defraud the revenue of its taxes by transacting at abnormally low prices. Having regard to the above observations of the AO, we are of the opinion that if the AO was not satisfied with the working given by the assessee, he ought to have computed the FMV himself in the method prescribed under the rules but ought not to have adopted higher of the prices paid by the assessee for purchase of some of the shares of M/s Optival as even when the transactions are between the related parties, the provisions of section 56(2)(viia) can be applied only in accordance with the prescribed method and the difference between the price at which the assessee has purchased the shares and aggregate of the fair market value of the shares as computed can be brought to tax as deemed income in the hands of the assessee……"

***5.2**.Here,we would like to refer to the case of Taparia Tools Ltd.(372 ITR 605)of the Hon'ble Apex Court. In that matter the assessee was following the mercantile system of accounting. It floated an issue of non-convertible debentures under the terms and conditions of which subscribers were given two options as regards the payment of interest thereupon : they could either receive interest half yearly at 18 per cent. per annum over a period of five years or opt for a one-time payment of Rs. 55 per debenture to be immediately paid. At the end of the five-year period, the debentures were to be redeemed at the face value of Rs. 100.*

Two subscribers gave their letter of acceptance opting for payment of interest upfront and were accordingly paid interest in sums of Rs. 2,72, 25,000/and Rs. 55 lakhs, respectively, in the accounting years 1995-96 and 1996-97,respectively. It showed the upfront payment of interest on debentures as deferred revenue expenditure in the accounts to be written off over a period of five years. However, in its returns for the AY.s 1996-97 and 1997-98, it claimed the entire upfront interest payment as fully deductible expenditure. The AO denied the assessee's claim and instead, spread the deduction over a period of five years thereby giving deduction only to the extent of one-fifth in each of the respective assessment years. The FAA, Tribunal and the High

https://itatonline.org

Court maintained the method of deduction adopted by the AO. Allowing the appeal, the Hon'ble Supreme Court held as under:

"….. the disallowance of the deduction on the ground that the debentures were issued for a period of five years was clearly not tenable. Two methods of payment of interest were stipulated in the debenture issued. ***By allowing only one-fifth of the upfront payment actually incurred, though the entire amount of interest was actually incurred in the very first year, the Assessing Officer, in fact, treated both methods of payment at par, which was clearly unsustainable. By doing so, the Assessing Officer, in fact, tampered with the terms of issue, which was beyond his domain*** *(emphasis added).On exercise by the subscriber of the option for upfront payment of interest in the very first year, the assessee paid that amount in terms of the debenture issue and by doing so it was simply discharging the interest liability in that year thereby saving the recurring liability to interest for the remaining life of the debentures because for the remaining period the assessee was not required to pay interest on the borrowed amount. By discharging the liability to interest in the first year of the issue itself, the assessee had benefited by making payment of a lesser amount of interest in comparison with the interest which was payable under the first mode over a period of five years. …..the moment the second option was exercised by the debenture holder to receive the payment upfront, the liability of the assessee to make the payment in that very year, on exercise of this option, had arisen and this liability was to pay Rs. 55 per debenture. Not only had the liability arisen in the assessment year in question, it was even quantified and discharged as well in that very accounting year. …..the assessee did not seek to spread this expenditure over a period of five years as in its return, it had claimed the entire interest paid upfront as deductible expenditure in the same year. When this course of action was permissible in law to the assessee as it was in consonance with the provisions of the Act which permit the assessee to claim the expenditure in the year in which it was incurred, the fact that a different treatment was given in the books of account could not be a factor which would bar the assessee from claiming the entire expenditure as a deduction. Once a return in that manner was filed, the Assessing Officer was bound to carry out the assessment applying the provisions of the Act and not to go beyond the return. There is no estoppel against the statute and the Act enables and*

https://itatonline.org

entitles the assessee to claim the entire expenditure in the manner it is claimed."
Considering the ratio of Taparia Tools(supra),we hold that the AO had 'tampered' with the provisions of the Act.

Section 56 allows the assessees to adopt one of the methods of their choice. But, the AO held that the assessee should have adopted only one method for determining the value of the shares. In our opinion ,it was beyond the jurisdiction of the AO to insist upon a particular system, especially the Act allows to choose one of the two methods. Until and unless the legislature amends the provision of the Act and prescribes only one method for valuation of the shares, the assessee are free to adopt any one of the methods. Therefore, n our opinion the order of the FAA does not suffer from any factual or legal infirmity.

8. Similarly, the Bombay High court, in the case of Vodafone M-Pesa Ltd. vs PCIT (supra), the Hon'ble court has held that the Ld. AO cannot change the method adopted by the assessee for valuing the market value of the shares from discounted cash flow method to net asset value method, which was violation of Rule 11UA and accordingly, the impugned order was to be set aside. Similarly, the co-ordinate bench in the case of Vodafone M-Pesa Ltd vs PCIT (supra) has held that the Ld. AO cannot change the method of valuation adopted by the assessee by merely relying on the actual results in the subsequent years and arbitrarily coming to the conclusion that projections were not achieved. We, therefore respectfully following the decisions as discussed above, set aside the order the Ld.CIT(A) and direct the Ld. AO to delete the additions.

9. In the result, appeal filed by the assessee is allowed.

https://itatonline.org

Order pronounced on 28 /7/2020 under rule 34(4) of the ITAT Rules 1963.

Sd/-	**Sd/-**
(Amarjit Singh)	**(Rajesh Kumar)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Mumbai, Dated : 28/07/2020
*** *Thirumalesh, Sr.PS***

Copy of the Order forwarded to :

1. The Appellant.
2. The Respondent.
3. The CIT(A), Mumbai.
4. The CIT
5. The DR, 'H' Bench, ITAT, Mumbai BY ORDER

(Assistant Registrar)
Income Tax Appellate Tribunal, Mumbai

https://itatonline.org