

**IN THE INCOME TAX APPELLATE TRIBUNAL "H", BENCH
MUMBAI**

BEFORE SHRI M.BALAGANESH, AM

**&
SHRI AMARJIT SINGH, JM**

**ITA No.1703/Mum/2019
(Assessment Year : 2015-16)**

| | | |
|--|-----|---|
| M/s. Keva Industries Pvt. Ltd C/O. SH Kelkar and Company Limited LBS Marg, Mulund West Mumbai – 400 080 | Vs. | Income Tax Officer, 15(2)(1) Room No.480, 4 th Floor Aayakar Bhavan Mumbai – 400 020 |
| PAN/GIR No. AAFCK6140B | | |
| (Appellant) | .. | (Respondent) |

| | |
|------------------------------|---|
| Assessee by | Shri Jehangir Mistry and Shri Harsh Kothari |
| Revenue by | Shri B. Srinivas |
| Date of Hearing | 11/10/2019 |
| Date of Pronouncement | 16/10/2019 |
| | |

आदेश / ORDER

PER M. BALAGANESH (A.M.):

This appeal in ITA No.1703/Mum/2019 for A.Y.2015-16 arises out of the order by the Id. Commissioner of Income Tax (Appeals)-24, Mumbai in appeal No.CIT(A)-24/ITO-15(2)(1)/IT-242/2017-18 dated 11/03/2019 (Id. CIT(A) in short) against the order of assessment passed u/s.143(3) of the Income Tax Act, 1961 (hereinafter referred to as Act) dated 29/12/2017 by the Id. Income Tax Officer-15(2)(1), Mumbai (hereinafter referred to as Id. AO).

2. The Ground No. (A) raised by the assessee is with regard to challenging the validity of assessment framed u/s 143(3) of the Act dated 29.12.2017 on the ground that no notice u/s 143(2) of the Act was issued / served on the assessee after the filing of revised return by the assessee , which was also filed within the time prescribed u/s 139(5) of the Act. There is no dispute that notice u/s 143(2) of the Act was indeed issued and served on the assessee within the prescribed time limit after the filing of original return of income u/s 139(1) of the Act. Though the assessee had raised various grounds (vide Sub Grounds 1 to 4 in Ground A) in this regard and though certain arguments were indeed made by both the parties before us, the Id Senior Counsel for the assessee stated that he would like to argue the issue on merits. In the peculiar facts and circumstances of the case before us, we treat the Grounds 1 to 4 raised by the assessee as not pressed.

3. The Ground No. (B) raised by the assessee is against the action of the Id CITA confirming the addition made in the sum of Rs 107,40,00,000/- u/s 56(2)(viiia) of the Act.

4. The brief facts of this issue are that the assessee is a company engaged in the business of manufacturing and distribution of natural and synthetic essential oils and aromatic chemical resinoids. The return of income for the Asst Year 2015-16 was filed by the assessee on 15.9.2015 declaring loss of Rs 44,457/- . Later a revised return of income was filed on 20.9.2016 declaring the same loss figure of Rs 44,457/- with minor modification in the return. The reasons for revising the return was due to omission in showing investments of Rs 1,36,00,000/- in Schedule FA of original return of income made in M/s KNP Industries Pte Ltd , a Singapore based company. The shares of this company were purchased

from assessee company's directors who are also directors in KNP Industries Pte Ltd. The Directors of assessee company had acquired the shares in the year 2008 at Rs 34/- per share and they sold the shares to assessee company in Asst Year 2015-16 at the same rate of Rs 34/- per share on the basis of valuation done as per Discounted Cash Flow Method (DCF) of M/s KNP Industries Pte Ltd which was taken at USD 0.50 (Dollar rate considered at Rs 68) . Both the Directors Mr Kedar Vaze and Mr Ramesh Vaze booked Long Term Capital Loss of Rs 51,64,854/- on the transaction due to indexation. The Id AO asked the assessee company to furnish the basis and justification for valuation of purchasing the shares from its directors. The assessee submitted that the valuation of the shares were done as per DCF method and submitted valuation report of M/s Kaveri Venkataraman & Associates dated 5.2.2015 as per which valuation was taken at USD 0.50 i.e Rs 34/- per share. The Id AO asked the assessee company to submit the audited balance sheet and P&L account of M/s KNP Industries Pte Ltd for the years ending 2015 and 2016 (calendar year is followed in Singapore i.e January to December) and results were compared with the projection made during the valuation of share as per DCF method. The Id AO observed that there was huge variation in the projection made for the DCF method as under: -

| <i>Amounts in US\$</i> | | | | |
|--|--------------------------------------|--------------------------------------|--------------------------|---------------------------|
| <i>Particulars</i> | <i>2013</i> | <i>2014</i> | <i>2015</i> | <i>2016</i> |
| <i>Projection EBIT</i> | <i>-5000</i> | <i>220000</i> | <i>25000</i> | <i>27000</i> |
| <i>Actual EBIT as per audit report</i> | <i>-5209</i> | <i>220196</i> | <i>-79839</i> | <i>648851</i> |
| <i>Deviation</i> | | | <i>-104839</i> | <i>621851</i> |
| <i>Remarks</i> | <i>As per actual of earlier year</i> | <i>As per actual of current year</i> | <i>Variation of 419%</i> | <i>Variation of 2302%</i> |

4.1. Hence he issued a show cause notice dated 18.12.2017 to the assessee as to why the method of valuation of share as per DCF which was arrived upon at USD 0.50 should not be rejected as the same was not in line with the projections and valuation to be taken as per Rule 11UA of the Rules for making addition u/s 56(2)(vii) of the Act.

4.2. The assessee replied as under: -

a) The assessee acquired 400000 shares of KNP Industries Pte Ltd, a Singapore based company which was incorporated on 8.9.2008 and engaged in the business of Investment and Trading activities.

b) M/s Kaveri Venkataraman & Associates carried out the valuation of shares of KNP Industries Pte Ltd, Singapore as on 31.12.2014 by adopting DCF method, for which they had relied on the financial projections provided by KNP Industries Pte Ltd applying a discounting rate of 8.5% and perpetual growth rate of 1% in order to commensurate with the business model of KNP Industries Pte Ltd.

c) M/s Kaveri Venkataraman & Associates accordingly arrived at the fair value of share of KNP Industries Pte Ltd at USD 0.50 per share.

d) The assessee submitted that KNP Industries Pte Ltd is an investment company having main investment in S H Kelkar and Company Limited. In the year 2014 and 2016, KNP had earned dividend on this investment. S H Kelkar and Company Limited was owned by three factions. Due to **internal dispute , certain shareholders approached Hon'ble Company Law Board with the petitions of oppression and mismanagement. Finally on intervention of H'ble Company Law Board, the dispute was resolved and**

company could function smoothly again . Due to this reason, the company could not declare any dividend from 2005 to 2011. Hence the accumulated dividend was distributed over the next few years once operations of the company normalized. Hence the dividend was earned in **2014 and 2016. The assessee also enclosed the order of H'ble Company Law Board in CP Nos. 68 & 73/2005 and 66/2008 (Mum) dated 4.9.2009.**

e) The assessee submitted the Escrow Agreement dated 29.11.2013 between S H Kelkar and Company Limited and Blackstone Capital Partners (Singapore) VI FDI Two Pte Ltd, having registered office at Singapore, who came in as investor , by appointing Deutsche Bank AG, Hongkong Branch as an Escrow Agent.

f) The assessee submitted Shareholders Agreement dated 2.8.2012 relating to S H Kelkar and Company Limited between Blackstone Capital Partners (Singapore) VI FDI Two Pte Ltd (as BCP 1) and Blackstone Family Investment Partnership (Singapore) VI FDI Two Pte Ltd (as BCP 2) and Blackstone Family Investment Partnership (Singapore) VI-ESC FDI Two Pte Ltd (as BCP 3) and several persons named as Promoters including the list of confirming parties to the agreement and S H Kelkar and Company Limited (as Company).

5. The Id AO observed (i) that the assessee had contended that there was **a dispute in S H Kelkar & Co and matter was pending with the Hon'ble Company Law Board since 2005** ; (ii) that investment in KNP Industries Pte Ltd was made in 2008 much after the dispute and all the shares are held by Vaze family ; (iii) that no shares in KNP Industries Pte Lte was held by Kelkar family as such (iv) therefore, this dispute has nothing to do with reference to the valuation of share of KNP Industries Pte Ltd ; (v)

that KNP Industries Pte Ltd had invested in S H Kelkar & Co. which is a listed company and is listed in NSE and its price as on 20.11.2015 was Rs 291 ; (vi) that the assessee in its justification for valuation of shares had considered the same at Rs Nil which shows that assessee had taken all irrelevant data to arrive upon the valuation of USD 0.50 as per DCF valuation.

5.1. Based on the aforesaid observations, the Id AO observed that the valuation under DCF method worked out by the assessee as per the data provided by the management / directors was nothing but an eye wash and totally unrealistic and accordingly not acceptable. The Id AO observed that the valuer of shares had simply adopted the future cash flows certified by the management and no verification of projections and assumptions adopted by the management were carried out by the said valuer and hence he concluded that the entire valuation report was made as per the requirement of the management. The Id AO observed that there is no match between the projections and the actuals. The projections were made only on presumptions and assumptions which are not based on any reasonable variable. DCF method being a legitimate permissible method for the calculation of value of shares, should be based on certain variables. It cannot be used as a tool of reverse working / arithmetical calculation without any basis. Accordingly, the Id AO rejected the valuation of shares carried out by an independent valuer using DCF method and proceeded to adopt the book value of shares as per the provisions of Rule 11UA(2)(a) of the Income Tax Rules. The Id AO for this purpose observed that since on the date of issue of shares , KNP Industries Pte Ltd did not have its audited financials, the determination of fair market value of KNP Industries Pte Ltd was made on the basis of

audited balance sheet for the previous year ended on 31.12.2014 as under:-

| | | | |
|------|------------------------------|-----|------------------|
| | Book value of Assets | | US\$.2,37,95,451 |
| Less | Advance Tax/ TDS/TCS | Nil | |
| | Deferred revenue expenditure | Nil | Nil |
| | A | | US\$.2,37,95,451 |
| | Book value of Liability | | US\$ 6,09,317 |
| | L | | US\$ 6,09,317 |
| | PV | | US\$ 0.5 |
| | PE | | 289885 |

$$\begin{aligned}
 \text{Fair market value of unquoted equity shares} &= \frac{(A-L) * (PV)}{(PE)} \\
 &= \frac{(23795451-609317) * (0.5)}{289885} \\
 &= \text{US\$ } 39.99
 \end{aligned}$$

Same was converted to Indian Rs as taken by the assessee ie Rs 68 /US\$
 = Rs 2719.32
 = Say Rs 2719

5.2. Based on the above, the Id AO proceeded to make an addition u/s 56(2)(viiia) of the Act to the tune of Rs 107,40,00,000/- (400000 shares * (2719-34)) by treating the difference between the fair market value of the shares and the purchase price of the shares by the assessee .

6. Before the Id CITA, the assessee reiterated the submissions made before the Id AO and the crux of the arguments made before the Id CITA could be summarized as under:-

- a) The transaction of acquisition of shares by the assessee was merely a restructuring conducted to comply with the law of the land without any motive to create a benefit or gain.
- b) The Id AO erred in disregarding valuation of shares merely based on variations between actual performance vis-à-vis the projections.
- c) The provisions of Rule 11UA are not applicable to transaction of acquisition of shares of a foreign company.
- d) The Id AO erred in invoking Rule 11UA(2) which is applicable only in case of transaction u/s 56(2)(viib) of the Act, whereas the Id AO invoked the provisions of section 56(2)(viiia) of the Act.
- e) Without prejudice, the Id AO erred in arriving at valuation based on the balance sheet as on 31.12.2014. As per the aforesaid Rule relied upon by **the Id AO, the value of shares must be arrived at on the 'valuation date'**. Rule 11U(j) defines valuation date as the date on which the property or consideration, as the case may be, is received by the assessee. In the case of the assessee, the Id AO had relied on the balance sheet of KNP Industries Pte Ltd drawn up on 31.12.2014 to ascertain its fair value instead of taking the fair value as on the valuation date i.e 11.2.2015 , as prescribed in the said rule.

6.1. The assessee submitted the Balance Sheet of KNP Industries Pte Ltd as on 10.2.2015 together with a valuation report obtained from the auditor of KNP Industries Pte Ltd dated 29.3.2018 valuing the shares based on NAV method. These documents were filed as additional evidences before the Id CITA as adequate time was not available before the Id AO to furnish the said documents. The Id CITA admitted these documents as additional evidences and sought for a remand report from the Id AO. The said remand report was submitted by the Id CITA on 20.12.2018 objecting to the admission of additional evidences filed by the

assessee before the Id CITA. The Id AO in the remand report also stated that the valuation report dated 29.3.2018 suffers from various infirmities in as much as the same was not done by an independent auditor and that the same was furnished only by the auditor of KNP Industries Pte Ltd, Singapore and hence not reliable.

6.2. The assessee also filed a rejoinder to the remand report of the Id AO before the Id CITA on 29.1.2019. The assessee made preliminary objection that the remand report was submitted by the Id AO without affording any opportunity of being heard to the assessee and without causing any hearing to the assessee. It was submitted by the assessee that the valuation report, which was obtained in March 2018, demonstrates the fact that, notwithstanding the option available with the assessee company to value shares under DCF or NAV method, even if NAV method is adopted to value the shares, the valuation claimed by the Id AO was incorrect and arbitrary.

6.3. With regard to the objection of the Id AO that the valuation report furnished by the auditor of KNP Industries Pte Ltd, Singapore cannot be accepted, by stating that the same was in conflict of interest and more so that the same was furnished by the auditor by placing reliance on the projections / prospective results submitted by the management of KNP, the assessee submitted that Rule 11UA nowhere creates a restriction that Chartered Accountant of the company cannot value the shares. The assessee also submitted in this regard that the valuation of shares was done by the said auditor by using NAV method and hence there is no question of considering future projections, as wrongly alleged by the Id AO. Moreover, the said valuation of shares using NAV method was furnished by the auditor based on the audited financial statements as on

valuation date of 10.2.2015, which clearly proves the proper application of mind on the part of the said auditor. The assessee further submitted that in any case, the Id AO ought to have considered the basic fact that valuation must be conducted as on the date of transaction (i.e valuation date) for which purpose the audited financial statements of valuation date ought to have been considered by the Id AO. The assessee also pointed out the factual fallacy committed by the Id AO from the valuation report of the auditor by stating that the value per share as per NAV method as on the valuation date at USD 2.58 as against (-) USD 8.64. It was also pointed out that in view of weak financial results in quarter ended December 2014 of S H Kelkar and Co, prompted the promoters to actively consider Initial Public Offer (IPO) as a way to redeem the situation that was beginning to impinge on the shares that were pledged.

6.4. The assessee also drew the attention of the Id CITA to the submissions made before the Id AO with regard to the fact that the value of investments of KNP Industries Pte Ltd had diminished to a large extent due to various reasons which were explained in detail. These are reproduced in pages 30 to 34 of the order of the Id CITA. It was specifically pointed out by the assessee that the shares of S H Kelkar & Co which were owned by KNP Industries Pte Ltd were placed in escrow account and that during such period, when shares were placed in escrow, KNP could not have sold the shares in the open market due to the overriding charge created. Further, due to poor financial performance of S H Kelkar & Co. by December 2014 and consequent discussions among Blackstone Shareholder and promoters at the subsequent Board meeting of S H Kelkar & Co, it became probable that M/s Blackstone would exercise its right to escrow thereby resulting in forfeiture of shares and it is due to this reason, a provision for diminution in value of investment

was made. In nut shell, the value of shares of S H Kelkar & Co held by KNP Industries Pte Ltd was virtually zero. Hence it was pleaded that the observation of the Id AO that the provision for diminution in value of investments ought not to have been made in the balance sheet as on the valuation date is incorrect.

7. The Id CITA however, rejected all the contentions of the assessee as detailed above and upheld the findings of the Id AO. Aggrieved, the assessee is in appeal before us.

8. We have heard the rival submissions and perused the materials available on record including the judicial pronouncements relied upon by both the sides at the time of hearing before us. During the year under consideration, the assessee company acquired 400000 shares in KNP Industries Pte Ltd, Singapore. These shares were acquired from Mr Kedar Vaze and Mr Ramesh Vaze, who were holding 200000 shares each in KNP Industries Pte Ltd, Singapore. The said shareholders are the directors in the assessee company and hold 50% shares each in the assessee company. Those two shareholders had acquired the shares in KNP Industries Pte Ltd in the year 2008 for Rs 68,00,000/- each thereby making the total cost at Rs 1,36,00,000/-. Pursuant to the above, in the year 2015, RBI / FEMA changed the norms with regard to investment in foreign shares by a resident individual. As per the revised RBI notification No. FEMA 263/RB-2013 dated 5.3.2013, it was notified that resident individuals are prohibited from making direct investment in a Joint Venture of wholly owned subsidiary abroad. This fact is not in dispute before us. In order to comply with the above legal requirement, Mr Kedar Vaze and Mr Ramesh Vaze transferred the shares to the assessee company in Asst Year 2015-16. Infact for acquiring the shares worth Rs

1.36 crores from the directors, the assessee company in turn took loan of the very same amount from its directors to make payment to the directors for acquisition of shares of Rs 1.36 crores. Therefore the motive of the transaction was not to make any gains but to comply with the law. It is not in dispute that the assessee company is also owned equally by Mr Kedar Vaze and Mr Ramesh Vaze. The very purpose of incorporation of the assessee company was to fulfil the requirement of the aforesaid RBI regulations. The assessee company does not have any independent activity apart from the above acquisition of shares. The Id AR pleaded before us that the value at which the shares were acquired by the assessee company at Rs 1,36,00,000/- corresponds to the value at which the shares were originally procured by the directors. This itself corroborates the fact that the entire exercise of change in ownership was undertaken only to comply with the RBI / FEMA regulations and there was no intention to make any gains out of the said transaction. We find that the valuation of share has been arrived by an independent valuer by considering the future projections and performance of KNP Industries Pte Ltd. We find that the Id AO had disputed the valuation of USD 0.50 per share (considering dollar rate at Rs 68) based on actual results which had occurred subsequent to the date of valuation. It is an undisputed fact that the valuer while making valuation of shares under DCF method had to resort to the projections of performance of the company as furnished by the management. The valuer has to just look into the reasonableness of the said projections furnished by the management in the light of purpose behind the said valuation considering the totality of facts and circumstances. We find that the following points require consideration to understand the background of the case which would in turn have a significant bearing on the valuation of shares :-

a) S H Kelkar and Company Limited is engaged in the business of manufacturing aromatic chemicals, natural and processed essential oils, fragrances and flavours and in existence for more than 90 years.

b) In the year 2005, there were disagreements between groups of shareholders on certain decisions taken by Board of Directors of S H Kelkar and Company Limited due to which a group of shareholders viz Mr Ajit S Vaze, Mr Girish S Vaze and their families filed a case with the **Hon'ble Company Law Board against S H Kelkar and Company Limited u/s 397 and 398 of the Companies Act, 1956** towards Oppression and Mismanagement, which ultimately resulted in separation of two factions from the company viz The Ajit Vaze Faction and the G D Kelkar Faction. There was a stalemate in the group for almost more than 4 years on account of litigation.

c) Ultimately after 4 years of deliberation, the Honorable Company Law Board passed an order of settlement keeping in view interests of SHK and its various stakeholders.

d) However, as part of the settlement, the promoters of company had to raise capital to fund settlement cost of the existing factions from the company. Most financial institutions / banks do not grant loans for funding settlement costs. The banks, which did agree, demanded exorbitant rates of interest. Therefore, the promoters decided to raise capital in the form of private equity from M/s. Blackstone Capital Partners (Singapore) VI FDI TWO PTE. LTD (hereinafter referred to as "Blackstone" or "Investors")

e) In accordance with the above, a shareholders agreement was executed on 02.08.2012. One of the conditions in the shareholders agreement was protection to the Investors in the event of their exit without procuring the agreed IRR on their investment i.e. in the event of exit of Blackstone from SHK without procuring the agreed IRR on investment, the promoters of the company would become personally liable to make good the loss incurred by Blackstone. It may be noted that KNP is part of promoters group of SHK.

f) For this purpose, the shares of SHK held by KNP were placed in escrow-account which was in the custody of Deutsche Bank AG, Hongkong Branch (which acted as the Escrow Agent to the above arrangement)

g) It was agreed that if any specified event occurred (resulting in loss of wealth for Blackstone), the escrow agent shall handover the shares of SHK held in the escrow account to the said M/s. Blackstone.

h) In view of the above condition, the shares of S H Kelkar & Co. owned by KNP Industries Pte Ltd were placed in escrow account. During such period when shares were placed in escrow, KNP Industries Pte Ltd could not have sold the shares in the open market due to the overriding charge created. Further, if any adverse event was triggered, the shares would have been directly handed over by escrow agent to Blackstone (who had been roped in as an investor). In nutshell, the value of shares of S H Kelkar & Co. held by KNP Industries Pte Ltd was virtually zero.

8.1. We find that the Id AR submitted that the valuation report issued by an independent valuer had taken due cognizance of the aforesaid facts

and the attached encumbrances thereon and accordingly had determined the value per share at USD 0.50. However, the Id AO had rejected the valuation per share based on DCF method due to variations arising in actual vis a vis the projections. From due appreciation of the entire facts narrated above, we find that the valuation of USD 0.50 per share of shares of KNP arrived in the valuation report is to be accepted as just and fair in view of the fact that the main investment in KNP Industries Pte Ltd is in the shares of S H Kelkar and Company Limited. It is not in dispute that these shares were **held in 'escrow account' for meeting obligations to** M/s Blackstone (investor). Due to poor performance of S H Kelkar and Company Limited as on Dec 2014, there was an anticipated net liability of KNP towards Blackstone, which had effectively brought the value of shares of KNP to negative. In these circumstances, the valuation per share of USD 0.50 per share is above the fair market value of the shares. The most crucial fact to be considered is that as on the date of valuation of shares, the valuer did not have the benefit of the actual figures which had happened subsequent to the valuation date. Valuation has been done based on future performance and projections of the valued company under DCF method. The actuals may vary with the projections. It is a calculated business risk and commercial decision taken by the respective investors by placing reliance on the share valuation report. In this factual matrix, the promoters of the assessee company came forward to sell the shares of KNP Industries Pte Ltd to the assessee company at the same price at which it was acquired by them originally, without having any benefit thereon, in order to comply with the regulations of RBI / FEMA. This goes to prove that the entire transaction has been carried out with a bonafide intention of all the parties. There is no dispute that DCF method is one of the recognized methods for valuation of shares as is done in the instant case. Considering the totality of facts and

circumstances of the case as detailed hereinabove, we hold that the rejection of DCF method of valuation of shares carried out by an independent valuer, is not proper.

8.2. With regard to the claim of long term capital loss by the directors in the sum of Rs 51,64,854/- is concerned, we find that the assessee had submitted before the Id CITA that the said claim was erroneously made due to indexation benefit and that the said claim of loss was withdrawn by the directors by filing revised return of income and taxes paid for the same by both the directors. This fact was not controverted by the revenue before us and hence there is absolutely no benefit derived by the directors also by selling the shares of KNP Industries Pte Ltd to the assessee company at the same purchase price of Rs 34 per share.

8.3. We find that the Id AO had applied the provisions of Rule 11UA of the Rules, which in our considered opinion, are not at all applicable to the instant transaction. We find that the Id AO had invoked the provisions of Rule 11UA(2)(a) of the Rules as is evident from para 4.16 of his order. We find that the Id AO had invoked the provisions of section 56(2)(viiia) of the Act read with Rule 11UA(2)(a) of the Rules for making the addition. We find that the provisions of Rule 11UA(2) of the Rules are applicable only in the case of issue of shares by an unlisted company under the provisions of section 56(2)(viib) of the Act. In this regard we find that the assessee had acquired shares in a foreign company i.e M/s KNP Industries Pte Ltd, Singapore. The Id AO had applied Net Asset Value Method (NAV method) and for this purpose had relied on the balance sheet of KNP Industries Pte Ltd as on 31.12.2014 which is prepared in accordance with the Companies Act of Singapore. We find that Rule 11U **define the word 'Balance sheet' as under:-**

“balance-sheet”, in relation to any company, means,—

(i) for the purposes of sub-rule (2) of rule 11 UA, the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company appointed under section 224 of the Companies Act, 1956 (1 of 1956) and where the balance-sheet on the valuation date is not drawn up, the balance-sheet (including the notes annexed thereto and forming part of the accounts) drawn up as on a date immediately preceding the valuation date which has been approved and adopted in the annual general meeting of the shareholders of the company; and

(ii) in any other case, the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor appointed under section 224 of the Companies Act, 1956 (1 of 1956)”

8.4. We hold that since the shares of a foreign company were acquired by the assessee company in the instant case, the Id AO ought to have relied on the balance sheet as audited by the auditor appointed under the Indian Companies Act. In the instant case, the Id AO had relied on the balance sheet of KNP Industries Pte Ltd, Singapore, which is prepared in accordance with Singapore Companies Act, which fact is not in dispute before us. Admittedly, the case of the assessee falls squarely on clause **(ii) of the definition of 'Balance Sheet' as defined** in Rule 11U of the Rules supra. Hence it is mandatory to draw a balance sheet as on the valuation date i.e. 10.2.2015 /11.2.2015 (being the date of purchase of shares by the assessee company) and that the said balance sheet should have been audited by an auditor appointed under section 224 of the Companies Act, 1956. Hence it could be safely concluded that the Id AO had applied the valuation method on a different date which is not in accordance with law and that since the computation mechanism provided in Rule 11UA of the Rules is not applicable to the facts of the instant case, the

provisions of section 56(2)(viiia) of the Act also could not be invoked. It is well settled that the charging provision and the computation provision should be read together in order to make the said provisions workable in accordance with law. Reliance in this regard has been rightly placed by **the Id AR on the decision of Hon'ble Supreme Court in the case of CIT vs Official Liquidator, Palai Central Bank Ltd (In Liquidation)** reported in (1985) 1 SCC 45 wherein it was held that :-

"When there is a case to which the computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section. Otherwise, one would be driven to conclude that while a certain income seems to fall within the charging section there is no scheme of computation for quantifying it."

8.4.1. Similar views were endorsed by yet another celebrated decision of **Hon'ble Supreme Court in the case** of CIT vs B.C.Srinivasa Shetty reported in 128 ITR 294 (SC).

8.5. We find that the assessee before the Id CITA had furnished the balance sheet of KNP Industries Pte Ltd as on the valuation date i.e 10.2.2015. We find that the assessee had also furnished a valuation report dated 29.3.2018 from the auditor of KNP Industries Pte Ltd, Singapore based on the balance sheet as on 10.2.2015 as stated supra and by applying NAV method. These documents were indeed admitted by the Id CITA as additional evidences and a remand report was called for from the Id AO, which was duly submitted by the Id AO. The Id AO had pointed out that the value per share as per the said valuation report of auditor of KNP Industries Pte Ltd as on the date of valuation was USD 2.58. We have gone through the said valuation report of auditor of KNP Industries Pte Ltd which are enclosed in pages 444 to 447 of the paper

book of the assessee. From the said valuation report, we find that the valuer had categorically stated as under:-

3.2. Valuation Conclusion

*Based on the aforesaid method, the fair value per Ordinary Share of KNP INDUSTRIES PTE LTD is **United States Dollar 2.58 per share**. The detailed working of the valuation of the KNP INDUSTRIES PTE LTD under NAV method is provided as **Annexure 1**.*

*As against the valuation of US\$ 2.58 per share, as aforesaid, based on net value of assets of KNP INDUSTRIES PTE LTD., Mr Ramesh Vinayak Vaze and Mr Kedar Ramesh Vaze have an obligation to meet the value of investment put in by Mr Tan Cheng Hai of USD 4,500,000 which is secured by way of pledge of Mr Ramesh Vinayak Vaze and Mr Kedar Ramesh Vaze shares in his favour. **Accordingly, the value of shares in the hands of Mr Ramesh Vinayak Vaze and Mr Kedar Ramesh Vaze comes to USD (-) 8.64 being the net value after adjusting the value of obligation towards Mr Tan Cheng Hai which is valued at US\$ 4,500,000.***

(Emphasis supplied by us)

8.5.1. We find that the lower authorities had not looked into the para 3.2 of the valuation report in full and had only taken that part of the report which is favourable to the revenue alone. It is not in dispute that the assessee company had purchased the shares of KNP Industries Pte Ltd only from its directors i.e Mr Ramesh Vinayak Vaze and Mr Kedar Ramesh Vaze. The aforesaid valuation report clearly states that the value per share in the hands of these two directors as on the valuation date using NAV method would be USD (-) 8.64 per share. In these circumstances, the value per share at USD 2.58 in the hands of KNP Industries Pte Ltd as on the valuation date is not relevant and accordingly the entire observations made in this regard by the Id AO in the remand report which was relied upon by the Id CITA deserves to be dismissed. We find that as against the value per share on the valuation date of USD(-) 8.64 per share, the assessee company had purchased the shares from its directors

at Rs 34 per share cannot be objected by the revenue. We also appreciate the contention of the Id AR that there is absolutely no prohibition in the provisions of Rule 11UA that the chartered accountant of the company cannot involve in valuation of shares. Accordingly, the observation made on account of conflict of interest in this regard deserve to be dismissed. We also find that the Id CITA had observed that the financial statements as on 10.2.2015 were unaudited and had been certified only by the directors. In this regard, we find from page 451 of the paper book that the auditor of KNP Industries Pte Ltd had furnished a review report to the management of KNP Industries Pte Ltd , wherein it had been categorically mentioned that based on their review of the said financial statements, nothing had come to their attention that caused them to believe that the accompanying financial statements were not presented fairly, in all material respects , in accordance with International Financial Reporting Standards. Hence it could be safely concluded that the financial statements submitted by the assessee as on 10.2.2015 cannot be simply brushed aside as it had got the blessing of the chartered accountant by way of Review Report.

8.6. We find that the main reason for rejection of the original valuation report submitted by Kaveri Venkataraman & Associates dated 5.2.2015 using DCF method, was that there was huge discrepancy in the amount of estimate vis a vis the actual performance. In this regard, what is to be seen is the availability of data on the date of valuation i.e on 5.2.2015 by the valuer. At that point in time, an independent valuer would have to necessarily rely on the projected performance and estimates provided by the management for the purpose of valuation of shares under DCF method. There is no dispute that M/s Kaveri Venkataraman & Associates is an independent valuer. There is absolutely no conflict of interest

alleged on them by the revenue. Hence based on the projections given by the management of KNP Industries Pte Ltd, the valuation exercise was carried out by Kaveri Venkataraman & Associates on 5.2.2015 and accordingly value per share using DCF method was arrived at USD 0.5 (equivalent to Rs 34 per share). This rate of Rs 34 per share was finally used for purchasing the shares by the assessee company from its directors on the valuation date i.e 11.2.2015. There is no dispute that valuation of shares using DCF method is one of the recognized methods provided in the statute. Hence we do not find any infirmity in the said valuation report of Kaveri Venkataraman & Associates dated 5.2.2015 valuing the share at Rs 34 using DCF method. We would at this point in time, at the cost of repetition, would like to reiterate that the shares were merely purchased by the assessee company from its directors only in order to comply with RBI and FEMA guidelines.

8.7. We find that there is no dispute that the assessee company had acquired the shares of a foreign company from its directors. We also find the provisions of section 56(2)(viiia) of the Act refers to transaction of acquisition of any property being shares of a company not being a company in which public are substantially interested. Since foreign company does not fall in the above category, the provisions of Section 56(2)(viiia) of the Act cannot be said to apply to the above transaction. In any case, at the cost of repetition, the Id AO ought not to have considered the balance sheet as on 31.12.2014 for determining the value per share using NAV method, in view of the fact that the Rule specifically provides that balance sheet as on the date of valuation i.e 11.2.2015 should be considered for valuation. Rule 11 U defines valuation data as the date on which the property or consideration, as the case may be, is received by the assessee. Since the shares were acquired by the assessee

company on 11.2.2015 (being the valuation date) , the valuation arrived at by the Id AO relying on financial statements as on 31.12.2014 deserves to be ignored and disregarded as not being in consonance with the Rule.

8.8. We hold that the provisions of section 56(2)(viiia) of the Act cannot apply to a foreign company as the relevant Rule 11U which defines **'balance sheet' was not applicable to a foreign company**. We find that the amendment in this regard was brought in Rule 11U with effect from 1.4.19 under Rule 11U(b)(ii) of the Rules. This amendment is only prospective in nature and cannot apply to the year under appeal. We hold that the case of the assessee company herein falls under old provision of Rule 11U(b)(ii) of the Rules which reads as under: -

11U(b) "balance sheet" , in relation to any company, means , -

(ii) in any other case, the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor appointed under section 224 of the Companies Act, 1956 (1 of 1956)

The amended rule 11U with effect from 1.4.19 is as under: -

11U(b) "balance sheet" , in relation to any company, means , -

[(ii) in any other case, -

(A) in relation to an Indian company, the balance sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company appointed under the laws relating to companies in force; and

(B) in relation to a company, not being an Indian company, the balance sheet of the company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company, if any, appointed under

the laws in force of the country in which the company is registered or incorporated;】

Hence we hold that no method was prescribed earlier for valuation of shares of a foreign company i.e KNP Industries Pte Ltd prior to Asst Year 2019-20, which mischief was sought to be rectified by way of an amendment made in the rules under Rule 11U(b)(ii) of the Rules w.e.f. 1.4.19 having prospective applicability.

8.9. We find that the Id DR fairly agreed that the Id CITA wrongly applied the amended rule in his order which is not applicable to the facts of the instant case. But he prayed for remanding this issue back to the file of Id CITA for fresh adjudication to address on the pre-amended rule thereon. **The Id DR also argued that Rule 11U defines the term 'balance sheet' wherein the expression 'any company' is used. Accordingly, he argued that the expression 'any company' should be construed to include foreign company also.** We are not inclined to agree to this argument of the Id DR in view of the fact that this would make the subsequent amendment in the Rules specifically bringing the valuation rules in respect of foreign company, redundant. As we have already held supra that the legislature had sought to rectify the mischief hitherto prevailing upto Asst Year 2018-19 in the statute / rule and had accordingly brought an amendment effective from Asst Year 2019-20 onwards to curb the loophole available in the Act / Rules, hence we hold that the pre-amended definition of balance sheet cannot include foreign company therein. The Id DR later filed the comments dated 26.6.2019 received from the Id AO before the bench. We have gone through the same and we find that the same is nothing but reiteration of the findings already recorded in the assessment order which had already been dealt by us hereinabove. We are not inclined to agree to the contentions of the Id DR that the issue needs to

be remanded back to the file of Id CITA for fresh adjudication to decide in the light of pre-amended rule, as it would tantamount to giving a premium to the revenue to improve its case , which cannot be entertained by us, as the tribunal exercises only appellate jurisdiction.

8.10. In view of our aforesaid observations in the facts and circumstances of the instant case, we direct the Id AO to delete the addition made in the sum of Rs 107,40,00,000/- u/s 56(2)(vii) of the Act. Accordingly, the grounds raised by the assessee are allowed.

9. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on this 16/10/2019

Sd/-
(AMARJIT SINGH)
JUDICIAL MEMBER

Sd/-
(M.BALAGANESH)
ACCOUNTANT MEMBER

Mumbai; Dated 16/10/2019
KARUNA, sr.ps

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. The CIT(A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER,

(Asstt. Registrar)
ITAT, Mumbai

<http://itatonline.org>