

**IN THE INCOME TAX APPELLATE TRIBUNAL “C” BENCH, MUMBAI
BEFORE MS SUCHITRA KAMBLE, JUDICIAL MEMBER**

AND

SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

ITA No. 7056/Mum/2019

(A.Y. 2013-14)

The Dy. Commissioner of
Income Tax 6(2) (1)
Room No. 504,
Aykar Bhavan
Maharishi Karve Road
Mumbai-400 020

Credtalpa Alternative
Investment Advisors Pvt
Ltd
8th Floor, Ashford Centre,
Vs. Shankar Rao Narayan Marg
, Lower Parel ,
Mumbai-400 013

PAN No. AAEECC6357K

Appellant

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Respondent

Revenue by

:

Shri Ashish Kumar DR

Assessee by

:

Shri Rahul Sarda
Advocate

Date of hearing :

16.12.2021

Date of Pronouncement:

19.01.2022

ORDER

PER PRASHANT MAHARISHI, AM:

1. This appeal is filed by the Asst Commissioner of income tax – 6 (2) (1), Mumbai (the learned assessing officer against the order passed by the Commissioner of income tax (appeals) – 12, Mumbai dated 21st of

August 2019 for assessment year 2013 – 14 raising the following grounds of appeal as Under:-

- i. on the facts and circumstances of the case and in law, the learned CIT – A erred in deleting the addition made by the assessing officer on account of business expenses and unabsorbed depreciation even though the pre-commencement expenses to setting up of the plant for business purposes, such income is required to be capitalized
- ii. On the facts and circumstances of the case and in law, the learned CIT – A erred in deleting the addition on the basis of the decision of the learned CIT (A) with respect to AY 2012-13 where the CIT (A) has granted relief to the assessee on the basis of additional evidence submitted by the assessee before CIT (A). The assessing officer should be given opportunity by the CIT (A) Under rule 46A of the income tax act before allowing assessee's appeal
- iii. on the facts and circumstances of the case and in law, the learned CIT (A) erred in deleting the addition made by the assessing officer u/s 56 (2) (viib) of the act without appreciating that facts that the ld AO had interfered with the taxpayer statutory right Under rule 11 UA (2) of the ITR to the method of valuation and also that the of rejecting the taxpayer's valuation, the AO had the authority to carry out its own independent valuation and adopt the NAV method for this purpose.
- iv. On the facts in the circumstances of the case and in law, the learned CIT (A) erred in deleting the addition made by the assessing officer u/s 56 (2) (viib) of the act without appreciating the facts that the matter of taxability cannot be decided on the basis of entries which the assessee may choose to make his account but has to be decided in accordance with the provisions of law.

2. As per the facts available on record assessee, company is engaged in the business of providing investment advisory services. It filed its return of income on 13/9/2013 claiming a loss of ₹ 31,840,479/- comprising of business loss of Rs 2, 60, 37,039 and the capital loss of ₹ 5,803,440. The case of the assessee was picked up for scrutiny.
3. During the course of the assessment proceedings, the learned assessing officer noted that revenue shown in the profit and loss account for two consecutive years is nil where assessee has claimed for this year a sum of Rs 28,730,737 as expenditure under the head finance cost, employee benefit expenses depreciation and other expenses. As no revenue has been generated for the last two years he issued a show cause notice for disallowance of the entire claim of expenditure. The assessee submitted that it has incurred expenses for profitable future and to establish itself in the businesses and the expenses were of such a nature that had to be compulsorily incurred either by way of remuneration or by way of complying with various legal requirements. It was further stated that considering the nature of the business of equity activity, assessee's success depend completely on the fund managers and credit required a lot of travelling. Assessee stated that a venture capital fund and a nonbanking financial company was established showing the motive of the assessee however during the year due to bad global conditions investment could not be raised and therefore there is no revenue generation. Assessee also submitted that the failure to generate revenue was only due to the inability of the assessee in accumulating funds due to bad global financial condition and mere absence of revenue shall not be conclusive evidence that the expenses were not incurred for the purposes of the business. The learned assessing officer after considering the submission of the assessee followed his own order for assessment year 2012-13 and disallowed the entire business expenditure/loss claimed by the assessee of Rs 2, 60,37,039.

4. The learned assessing officer further noted that assessee has received ₹ 69,000,000 and share capital consisting of share premium of ₹ 59,800,000 and assessee has not shown any income u/s 56 (2) (viib) of the act. AO further noted that the assessee has made the valuation of the sale using discounted cash flow method. As the assessee has not earned any revenue for several assessment years and has incurred losses consistently, the AO asked the assessee to furnish the valuation of sale as per rule 11 U and 11 UA by using net asset method. He also asked assessee to substitute the actual figures of revenue for financial year 2012 – 13, 2013 – 14, and 2014 – 15 in the discounted cash flow method valuation. Assessee submitted valuation of share using net asset method which comes to Rs (-) 3241/-. Assessee did not submit the valuation of discounted cash flow method substituting the actual figures and therefore the learned assessing officer issued a notice asking assessee to justify the premium as the fair market value of the shares is negative as per net asset value method, as the discounted cash flow method is not reliable, which do not have any correlation with the actual affairs of the assessee. The assessee submitted a detailed reply that assessee is a start-up company set up by Mr. Rajeev Mehrotra who is having a strong background of investment banking involved experience in the field of financial service act having a working experience of 9 years in Edelweiss financial services Ltd. During the year domestic venture capital fund approved by Securities and Exchange Board of India namely, Credit alpha alternative fund was set up by the assessee to act as a manager and raise investments domestically. However, due to the bad global financial conditions the assessee could not raise investments through the fund. To substantiate it, assessee also submitted the registration certificate and return filed with the SEBI. It was further submitted that provisions of Section 56 (2) (viib) exempts the venture capital fund from complying with the valuation norms of the provisions of the above Section. The assessee also explained the various

situations due to which the assessee could not generate any revenue for past years however, for financial year 2014 – 15 it submitted that it has started generating revenue. Assessee submitted the details of shares allotment made along with the valuation report adopting discounted cash flow method where the valuation of the share is derived at ₹ 75 per share. It further submitted that the discounted cash loan method is the only method of valuation assessee could have adopted, as the book value method is redundant for such business model and will defeat the purpose. The learned assessing officer examined the explanation of the assessee and looking at the wide variation between the valuations of the shares adopting two different methods, he once again directed the assessee to substitute the actual figures of performance in the discounted cash flow method valuation. Assessee did not furnish such computation, therefore, he held that the discounted cash flow method valuation used by the assessee is bogus and sham and has no connection with the real figures. The valuation was done with fictitious figures having no correlation with the actual affairs of the assessee. The valuation was done using imaginary figures to arrive at a pre-mediated value of ₹ 75 per share and therefore he rejected the same. The learned assessing officer further examined the valuation report and stated that the valuer has purely relied on the projected figures given by the management of the company. He also referred to the fact that the valuer reports in the valuation report that it was not responsible for accuracy and completeness of the valuation and he has not conducted any independent audit, due diligence review or validation of such financial and other information. The valuer also categorically states that it did not express any opinion or any form of assurance thereon and it accepted no responsibility or liability and the share value has been derived and determined on the basis of information provided by the management. The learned assessing officer extracted such observation of the valuation report in his order. He therefore held that even as per

the actual figures the valuation by the discounted cash flow method is negative. Accordingly, he made an addition of ₹ 69,000,000 to the total income of the assessee Under the provisions of Section 56 (2) (viib) of the act being the value exceeding the fair market value of the shares as according to him valuation of the share is in negative.

5. Accordingly assessment order was passed on 17th of March 2016 u/s 143 (3) of The Income Tax Act determining the total income of the assessee at ₹ 69,000,000/-.
6. The assessee aggrieved with the order of the learned assessing officer preferred an appeal before the learned CIT – A who passed an order on 21st of August 2019 wherein he deleted the addition of ₹ 69,000,000 made by the learned assessing officer. With respect to the disallowance of the business expenditure of Rs 2 39,70,421 and unabsorbed depreciation of ₹ 2,066,618/- the learned CIT – A allowed the claim of the assessee following the order of his predecessor for assessment year 2012 – 13 as the learned assessing officer has also made disallowance based for that reasons. Therefore, both the disallowance/addition made by the learned assessing officer were deleted.
7. Therefore, the learned assessing officer is aggrieved with that order and is in appeal before us as per the grounds of appeal stated above.
8. The learned departmental representative vehemently supported the orders of the learned assessing officer and submitted on ground no 3 & 4 that
 - i. Assessee has supported the valuation of the shares for issue stating that the discounted cash flow method has been adopted, however according to the actual performance there is a consistent loss incurred by the assessee.
 - ii. He further submitted that the learned assessing officer asked the assessee to substitute the actual performance figures in the discounted cash flow method valuation report which assessee did not do. Therefore, the assessing officer asked the assessee to

submit the report as per the net asset value method, which has negative valuation.

iii. He further submitted that the valuation report submitted by the assessee even on the discounted cash flow method was suffering from severe infirmities and therefore such a valuation report could not have been accepted by the learned CIT – A.

iv. He submitted that the learned CIT – A has deleted the addition relying upon the several judicial precedents; however, he failed to look at the actual valuation done by the assessee, which is devoid of any merit.

9. On ground, no 1 & 2, with respect to the disallowance of business expenses and losses, he relied upon the order of the learned assessing officer.

10. The learned authorised representative submitted that ground number 1 – 2 of the appeal are covered in favour of the assessee by the decision of the coordinate bench in assessee's own case for assessment year 2012 – 13 wherein the coordinate bench has deleted the identical disallowance/addition made by the learned assessing officer. He submitted that for this year, learned assessing officer has also followed the same logic and in fact relying on the order of assessment for assessment year 2012 – 13, disallowance has been made. He therefore submitted that the ground number 1 deserves to be dismissed.

11. Coming to the ground number 2 & 3, the learned authorised representative referred to the paper book containing 43 pages in the form of various replies submitted by the assessee during the course of assessment proceedings and further referred to paper book containing 15 judicial precedents.

i. He referred to the valuation report dated 14th of March 2013 wherein the background of the company and the source of the information as well as the limitation and disclaimers were mentioned by the learned valuer and thereafter based on the

discounted cash flow method, fair value of the equity shares of the company were determined at ₹ 75 per share. He referred to calculation as per discounted cash flow method for computation of the fair value of the shares and submitted that value as per the shares based on the Free cash flow is determined at ₹ 93 per share, however, discounted the same as assessee is being an unlisted company by 20% and therefore the resultant fair value per share was determined at ₹ 75 per share. He also referred to the projected profit and loss statement of the assessee for seven years. It was also pointed out that assessee in the valuation report itself has shown losses in year 2016 and 2017 while working out the projected cash flow. There is no infirmity pointed out in any of the workings submitted.

- ii. He submitted that assessee is engaged in the business as advisors to persons or entities both domestic as well as offshore for the purpose of investment of funds in all forms of investments including shares, debentures, bonds, depository receipts, options, derivatives, government securities, and other financial instruments. The assessee is carrying on the business as a consultant and advisor in that field. He therefore submitted that cash flow of the assessee solely depends on the advisory services fees. He further stated that for financial year 2014 – 15 the assessee has started generating revenue and therefore it cannot be said that the data used for the purpose of valuation of the shares based on discounted cash flow method are imaginary. He further submitted that the discounted cash flow method is based on the potential earning of the company whereas the book value method, as adopted by the learned assessing officer, is based on value of the net assets of the company. As the assessee

company is engaged in the business of provision of services and is driven by the fees earning and not based on the total assets base of the assessee company, these two methodologies are not comparable and the variation between the two methods should not prevent assessing officer in accepting the discounted cash flow method adopted by the assessee.

- iii. He further referred to the letter dated 17th of March 2016 stating that provisions of Section 56 (2) (viib) exempts venture capital fund and undertaking companies from complying with the valuation norms. For this proposition, he also submitted that assessee has submitted a copy of the SEBI registration certificates and return filed with it before the learned assessing officer.
- iv. He further referred to the provisions of Section 56 (2) and stated that venture capital undertaking if received funds as a share capital from a venture capital company or a venture capital fund, provisions of this Section do not apply. He further submitted that the fair market of the value of the shares shall be the value as determined in accordance with the method as prescribed u/r 11 UA of the IT Rules or any method as may be substantiated by the assessee to the satisfaction of the assessing officer. However, it does not give any authority to the learned assessing officer to substitute the method of the valuation, himself value the shares by changing the method from discounted cash flow method to net asset value method, and then make an addition in the hands of the assessee company.
- v. He further submitted that the deviations of actual figures from the projected figures are not the ground for challenging the valuation report. The valuation must be viewed as on the date of valuation looking forward and cannot be reviewed in

hindsight. For this proposition, he referred to the decision of honourable Bombay High Court in Securities and Exchange Board of India and Others (company application number 124 of 2013 in company scheme petition number 234 of 2011 and other connected matters). He extensively referred to the various propositions from that decision mentioned in paragraph number 44.6, 44.7 and 48.6.

- vi. He further referred to the decision of the honourable Bombay High Court stating that the learned assessing officer cannot change the basis of the valuation for the purpose of the provisions of Section 56 (2) of the act from DCF method to net asset value method as held in Vodafone M pesa Ltd versus Principal Commissioner Of Income Tax 256 taxmann 240 (Bom).
- vii. He further submitted that assessee has given the complete details about investors in the above company and therefore there is no tax abuse or any allegation with respect to the unaccounted money.
- viii. He referred to the decision of the Delhi ITAT in Spooner industries Private Limited versus ITO ITA number 2780/Del/2019 dated 28/12/2020 wherein it has been held that unless the valuation made by the assessee applying the discounted cash method is not found fault with by pointing out deficiencies and inadequacies, it cannot be rejected outright.
- ix. He further referred to the paragraph number 5.4 onwards of the order of the learned CIT (A). He therefore submitted that the action of the learned assessing officer, without pointing out any material deficiency in the figures of computation of discounted cash flow valuation, could not substitute his own method for valuation of those shares.

- x. He even otherwise submitted that the learned assessing officer is not an expert and it is not open for the assessing officer to challenge or change the method of valuation once adopted by the assessee and to modify the figure as per his own whims and fancies.
- xi. He further referred to the rule 11 UA (2) (b) of The Income Tax Rules stating that the valuation of the share must be based on the discounted free cash flow method as one of the option and there is no reason to compare the actual performance of the assessee company with the projected performance.
- xii. He further submitted that in case of a service company, the valuation of shares could only be made based on the discounted cash flow method, as the main source of intrinsic value of such shares is only the revenue generation and not the asset base.
- xiii. He further submitted that the valuation report submitted by the assessee is an opinion of the expert and necessarily it will have the basis for giving such an opinion, therefore, the learned assessing officer has not appreciated the fact that there are certain disclaimers and limitations bound to be mentioned by an expert. He submitted that despite this the learned assessing officer has not questioned the working of the discounted cash flow of the assessee but has merely doubted in hindsight stating them to be imaginary. Thus, he is verifying the valuation report dated 14th of March 2013 in March 2016 and then saying that the figures adopted by the assessee for year 2014 and 2015 are imaginary. He therefore submitted that the learned CIT – A has correctly deleted the addition made by the learned assessing officer.

12. We have carefully considered the rival contentions and perused the orders of the lower authority as well as perused the paper book filed by the assessee.
13. The ground number 1 and 2 is with respect to the disallowance deleted by the learned CIT – A on account of business expenses and unabsorbed depreciation. We find that this issue is squarely covered in favour of the assessee by the decision of the coordinate bench in assessee's own case for assessment year 2012 – 13 in ITA number 5294/M/2017 dated 27th of March 2019. The learned assessing officer has also made the addition for this impugned assessment year based on his order for assessment year 2012 – 13. As the issue for assessment year 2012 – 13 has been decided in favour of the assessee, we do not find any reason to deviate from the same. In view of this ground number 1 and two of the appeal of the learned assessing officer are dismissed.
14. Ground number 3 and 4 are with respect to the addition of ₹ 69,000,000 on account of the provisions of Section 56 (2) (viib) of the act. Assessee has issued share capital at ₹ 75 per share being face value of Rs 10/- each at a premium of Rs 65/- per share to Cumulative Alternative Advisors Private Limited. This is supported by the valuation report by the chartered accountant adopting discounted cash flow method as per certificate dated 14th of March 2013. According to the certificate, it has adopted seven financial years starting from 2013 – 2020. For 2013, 2016 and 2017 the discounted cash flow statement shows losses. For financial year 2014, 2015, 2018 – 2020 it shows profit before tax and depreciation. Based on this, value of each share based on the present value of free cash flow was determined at ₹ 93 per share and such value was discounted at the rate of 20% for unlisted company. Consequently, fair value per share was determined at ₹ 75 per share. The valuation report also shows cost of equity and weighted average cost of capital along with discount factors. It is also supported by the projected profit and loss statement and balance sheet for all those seven years. A

statement is also annexed thereto showing the projected revenue statement and the breakup of the revenue and consequent expenses with respect to all those years. This valuation report was questioned by the assessing officer for the reason that the actual performance of the assessee company is not in consonance with the projected financial statements used by assessee for deriving the fair market value of the shares adopting discounted cash flow method. According to him, actual performance of the assessee company shows losses where as the discounted cash flow statement shows the projected profits. He directed the assessee to substitute the actual figures against the projected figures in the working of the discounted cash flow method valuation. He also adopted the net asset value method or deriving value of share which was Rs (-) 3241/-. Based on this he made the addition u/s 56(2) (viib) of the act of the whole of the amount. The learned CIT – A deleted the same. Provisions of Section 56 (2) (viib) of the act provides that 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 shall be chargeable to tax as income in the hands of the company receiving such sum. Explanation to that subsection Section provides that

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 prescribed⁷³; 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;

18. Thus, the fair market value of the share shall be higher of the value as determined in accordance with the provisions of rule 11 UA or any other method, which can be substantiated by the assessee before the assessing officer. For the purpose of determining 'fair market value' of unquoted shares provisions of rule 11 UA (2) applies which gives an option to the assessee to either value the shares as per prescribed formula given in clause (a) or clause (b) which provides for the determination of the fair market value based on discounted cash flow method as valued by a merchant banker or a chartered accountant (till 24th of May 2018). In the present case the assessee has valued the shares according to one of the 'options' available to assessee by adopting discounted cash flow method. Therefore, such an option given to the assessee cannot be withdrawn or taken away by the learned assessing officer by adopting different method of valuation i.e. net asset value method. The method of valuation is always the option of the assessee. The learned assessing officer is authorised to examine whether assessee has adopted one of the available options properly or not. In the present case, the learned assessing officer has thrust upon the assessee, net asset value method rejecting discounted cash flow method for only reason that there is a deviation in the actual figures from the projected figures. It is an established fact that discounted cash flow method is always based on future projections adopting certain parameters such as expected generation of cash flow, the discounted

rate of return and cost of capital. In hindsight, on availability of the actual figures, if the future projections are not met, it cannot be said that the projections were wrong. To prove that the projections were unreliable, the learned assessing officer must examine how the valuation has been done. In a case future cash flow projections do not meet the actual figures, rejection of discounted cash flow method is not proper. If projected future cash flow and actual result matches, such situation would always be rare. For projecting the future cash flow certain assumptions are required to be made, there needs to be tested and then such exemptions becomes the base of estimation of such projected future cash flows. If there are no assumptions, there cannot be an estimate of future projected cash flows and then discounted cash flow method becomes redundant. For exercise of valuation, assumption made by the valuer and information available at the time of the valuation date are relevant. As the exercise of valuation must be viewed as on the date of the valuation looking forward and cannot be reviewed in retrospect. Further, the valuation is always made based on review of historical data and projected financial information provided by the management. Further report of expert will always include limitation and responsibilities but that does not make his report incorrect. Of course, if there are errors in the working of projected cash flow, estimating the projected revenue and projected expenditure as well as in adoption of cost of equity and discount factor, the learned assessing officer is within his right to correct it after questioning the same to the assessee. The learned assessing officer can also question the basic assumptions made by the valuer. If they are unreasonable or not based on historical data coupled with the management expectation, the learned assessing officer has every right to question it and adjust the valuation so derived at. However, if he does not find any error in those workings, he could not have rejected the same. Further the reason given by the learned assessing officer that the net asset value method and the discounted

cash flow method for valuation of the shares of the company gives a wide variation between them, we do not find any reason to find fault with the assessee in such cases. Both these methods have different approaches and methodologies therefore there are bound to be differences, but it does not give any authority to the learned assessing officer to pick and choose one of the method and make the addition. It is the assessee who has to exercise one of the options available under the provisions of the law for valuing the shares. The learned assessing officer needs to examine that method. Naturally, if the discounted cash flow method and net asset value method gives the same result, where would have been the need to prescribe the two methods in the law. In view of above facts, we do not find any infirmity in the order of the learned CIT – An in deleting the addition of ₹ 69,000,000 made by the learned assessing officer u/s 56 (2) (viib) of the act. Accordingly, ground number 3 and 4 of the appeal of the learned assessing officer are dismissed.

19. In the result, appeal of the learned assessing officer is dismissed.

Order pronounced in the open court on 19/01/2022

Sd/-
(MS SUCHITRA KAMBLE)
(JUDICIAL MEMBER)

Sd/-
(PRASHANT MAHARISHI)
(ACCOUNTANT MEMBER)

Mumbai, Dated: 19.01.2022
Sudip Sarkar, 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

BY ORDER,
Assistant Registrar
ITAT, MUMBAI