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India | Tax & Regulatory | For private circulation only | 6 March 2019

Global Business Tax Alert

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ITAT upholds disallowance of share-premium received in excess of FMV as is computed after rejecting Assessee’s valuation methodology.

Issue no: GBT/05/2019

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Facts of the case

- The Assessee, TUV Rheinland NIFE Academy Pvt. Ltd., had allotted 0.5 million shares of the face value of Rs.100/- to its parent company M/s. TUV Rheinland (India) Pvt. Ltd., at a premium of Rs.479/- per share during AY 2015-16.
- The Assessee received a consideration of Rs.289.5 million out of which an amount of Rs.239.5 million was towards share premium.
- The shares were valued under Discounted Cash Flow Method (DCF) method as per the valuation report of an independent Chartered Accountant.
- The AO rejected the valuation stating that the report has only relied on the values certified by the management of the Assessee, which had been prepared to justify the high premium.
- The AO determined the value of the shares using the Net Asset Value [NAV] method as per the provisions of Rule 11UA(2)(a) of the Income Tax Rules, 1962 [the Rules] and determined the fair market value [FMV] of the shares at Rs.84.20 per share as against Rs.479/- per share as determined by the Assessee, and disallowed the differential amount of Rs.197.4 million. The same was then was offered to tax u/s 56(2)(viib) of the Act as share premium which exceeded the FMV.
- On appeal before the CIT(A), AO's action was confirmed. Aggrieved by the CIT(A)'s order, the Assessee has filed an appeal before the ITAT.

Assessee's contentions:

- The price at which a transaction is made between a willing buyer and willing seller is the FMV and should not require any justification.
- Mere contention that the DCF method is based on the projections given by the management cannot be a valid ground for disregarding an expert's report.
- The FMV to be adopted may be based either on the NAV or the DCF method at the option of the Assessee. The tax authorities cannot prefer one method over the other.
- The Revenue Authorities' examination should be restricted to verify the arithmetical accuracy of the valuation and not beyond that.
- Section 56 of the Act intends to tax only income and not capital receipts. Share premium is a capital receipt.

Ruling of the ITAT

- The Assessee's arguments that the provisions of section 56(2)(viib) cannot include receipts of share premium, is not valid as the inclusion of provisions of section 2(24) of the Act vide the Finance Act, 2012 have specifically included such receipts within the definition of 'income'.

- Merely because a transaction is entered into with the consent of the buyer and seller is not a relevant consideration for the purposes of section 56(2) of the Act since the provisions require that the parties have agreed to transact at the FMV.
- The ITAT also held that the provisions of law does not make an exception to shares issued to the Promoter Company / parent company. It provides for taxing of any excess share premium over the FMV of the shares, irrespective of the character or position of the person to whom such shares are issued. Merely because the recipient of the shares is the parent company of the Assessee, does not give the Assessee freedom to value the shares at any price.
- As regards the crux of the issue, in connection with computing the FMV, the ITAT held as follows:
  - It is not correct to state that the valuation report has been disregarded by the AO, as a finding has been rendered that the basis of estimates adopted in the valuation report was not produced and the Assessee was unable to substantiate the same.
  - It is seen that neither has the AO questioned the Assessee's right to choose the method of valuation (viz. between DCF and NAV) nor has the Assessee placed forth contentions as to why the NAV method is inappropriate. Moreover, the assumptions used in the valuation report were far off from realisations that materialised subsequently.
  - The AO has thus adopted the NAV method, since the DCF method has not passed the test of scrutiny i.e. the basis of DCF method is not substantiated.
  - The facts of the current case are similar to a ruling of the co-ordinate bench of the Delhi ITAT in the case of Agro Portfolio Pvt. Ltd [TS-7311-ITAT-2018(Delhi)-O] wherein it was held that AO has the power to examine and verify the correctness or the reasonableness of the valuation adopted by the Assessee.
- Thus, the ITAT upheld the action of the AO in determining the share premium collected in the Assessee's hand u/s 56(2)(viib) of the Act r.w.r. 11UA(2)(a) of the Rules and ruled in favour of the Revenue.

Comments

- Rule 11UA(2) of the Rules prescribes two methods for valuation of fresh issue of unquoted shares - the NAV method or the DCF method in the case of section 56(2)(viib) of the Act.
- While the appropriateness of method of valuation adopted is highly fact specific, the above ruling of the Bangalore ITAT makes it clear that the selection of the appropriate method would have to be substantiated together with the basis of assumptions adopted.
- It may also be mentioned that the issue of taxation of 56(2)(viib) of the Act has acquired attention from the CBDT and the Finance Ministry. The tax community may expect greater clarification and relaxations going forward.

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