Deloitte.

# Tax Alert | Delivering clarity

1 April 2019

## ITAT deletes additions made u/s 56(2)(viib) to the total income on account of share premium received

Enhancement of income by the CIT(A) is deleted

### Facts of the case:

- Section 56(2)(viib) of the Act brings to tax any money received by a company from a resident on the issue of its shares to the extent it exceeds the fair market value (FMV) of the shares so issued. The FMV for such purposes would be the value as is prescribed in the Rules or such value as is substantiated before the tax officer based on the value of assets, whichever is higher.
- Section 56(2)(viib) has been brought into effect with effect from 01 April 2013 i.e. Assessment Year 2013-14 pertaining to Fiscal Year (FY) 2012-13.
- The Assessee, India Today Online Pvt. Ltd., had received share application money [SAM] amounting to Rs. 72.25 crores in the period pertaining to AY 2011-12 and AY 2012-13. In lieu of SAM of Rs. 72.25 crores received, shares were issued in September 2012.
- An additional sum was received in AY 2013-14 and AY 2014-15, against which shares were issued in the FY pertaining to AY 2014-15.
- SAM was received from Living Media India Ltd and shares were issued at a value of Rs. 30 per share, as against the face value of Rs. 10 per share. The same was supported by an independent chartered accountant's valuation report.
- The value of shares of the Assessee were derived primarily from value of shares of its subsidiary company – Mail Today News Paper Private Limited.
- The Assessing Officer (AO) and the CIT (Appeals) made additions to the taxable income of the Assessee under Section 56(2)(viib) of the Act on various grounds covering facts specific to the Assessee and on interpretation/application of the provisions.

The key aspects of the decision rendered for AY 2013-14 and 2014-15 are highlighted hereunder.

### Ruling of the ITAT:

**Section 56(2)(viib) should apply at the time of issue of shares – finding of CIT(A) not disturbed**

- The AO had made addition to income under Section 56(2)(viib) of the Act in relation to the SAM received [i.e. amounting to Rs. 135 crores] in AY 2013-14. The AO did not disturb the method or value determined by the Assessee except for adjusting the value marginally for difference in percentage of stake held by the Assessee in its subsidiary.
- The CIT(A) deleted the adjustment made by the AO for the reason that the shares were issued only in the next FY and therefore, provisions of Section 56(2)(viib) of the Act would apply only in the year of issue of shares. As the same was deleted by the CIT(A), the ITAT did not adjudicate on the same.

- However, the CIT(A) treated the receipt of SAM in earlier years [amounting to Rs. 72.25 crores] as taxable under Section 56(2)(viib) of the Act in the said year, by determining the FMV as per NAV method under Rule 11UA(2)(a) as shares were issued in the captioned year. The decision of the ITAT in this context is discussed hereunder.

**Jurisdiction of the CIT(A) to make the enhancement:**

- Section 56(2)(viib) of the Act prescribes that FMV shall be the higher of the following:
  - as per the method prescribed by the Act or
  - as may be substantiated to the satisfaction of the AO
- In the present case, AO has not doubted the substantiation of the value of the shares and the valuation method except the minor mathematical adjustment to the shareholding percentage.
- Therefore, where AO has not tinkered with the valuation of shares shown by the Assessee, and has accepted the valuation report produced by the Assessee, the CIT(A) does not have jurisdiction to tinker with the same.

**Rule 11UA to not apply if the same was not notified as on date of issue of shares**

- Section 56(2)(viib) of the Act was made applicable from FY 2012-13 and the relevant rules were prescribed w.e.f 29 November 2012.
- The CIT(A) held that the FMV of the shares were to be determined in accordance with Rule 11UA.
- The ITAT held that the shares were issued in September 2012, which was issued before the applicability of the provisions of Rule 11UA of the Act. As there was no prescribed method of Rule 11 U & UA for determination of the market value on the date of allotment of shares, it would be implausible to hold that valuation report is not correct.

**Method of valuation of the FMV of the Company**

- The CIT(A) noted that the shares of the Company mainly derived its value from the subsidiary company. In this regard, the CIT(A) held that the said subsidiary company was continuously incurring losses and its net worth had eroded and therefore, the FMV of such shares would be negative.
- The ITAT held that valuation of the shares cannot be made simply on the basis of financial statements but has to take into consideration various factors. Simply relying upon the project report or statement wherein the said auditor has reported that Mail Today was in losses and book value of the shares is negative, and extrapolating such statement to infer the value of the shares shown by the Assessee is incorrect and would not be proper, especially, when the same auditor/valuer has valued the shares of Mail today at Rs. 44.78.
- On a separate note, the ITAT also commented that DCF method is a recognised method where future projections are made based on various factors. Applying the benefit of hindsight, it cannot be matched with actual performance, and what Ld. CIT (A) is trying to do is to evaluate the actuals to show that the Company was running into losses. Therefore, DCF is not correct.
- Valuation under DCF is not exact science and can never be done with arithmetic precision. Hence the valuation by a valuer has to be accepted unless, specific discrepancy in the figures and factors taken are found.
- When law envisages that the FMV can be determined in either of the two manners, whichever is higher (as granted in Section 56(2)(viib), so as to demonstrate that the value of shares does

not exceed the FMV, then AO cannot insist on following only one particular method. Here the Assessee had substantiated the fair market value which was much higher and the shares have been issued at lower price. It would be incorrect to hold that substantiation made by the Assessee has to be in accordance with Rule 11U/11UA.

- Based on the above, the ITAT held that no adjustment is required to be made under Section 56(2)(viib) of the Act.

**For AY 2014-15:**

- For the said year, the AO disregarded the valuation report of the Assessee for the reason that the subsidiary had been incurring losses and that there is a huge difference between the projections used in the valuation and the actual results and was upheld by the CIT(A).
- The ITAT held that the Assessee has been able to show that the aggregate consideration received and the shares which were issued, does not exceed FMV and has demonstrated the value as contemplated in Explanation (a) and therefore, the working of the Assessee as per Explanation (a) sub clause (ii) has to be accepted.
- The ITAT relied on its findings for AY 2013-14 (discussed above) and deleted the addition made.

## Comments:

- Section 56(2)(viib) of the Act prescribes the FMV to be higher of the value as per Rule 11UA or the value as is substantiated by the Assessee.
- Rule 11UA thereafter offers two approaches – DCF and NAV (subject to modifications specified therein).
- The ITAT in this decision upholds and also clarifies upon the Assessee’s right to pursue a separate method of valuation (based on assets) as is provided in clause a (ii) of Explanation to Section 56(2)(viib).