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Hyderabad ITAT rules that 'fair market value' to be computed as per the prescribed provisions of the Act thereby deleting the addition made by assessing officer

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In this issue:

- Executive Summary
- Facts
- Issues before Hyderabad ITAT
- Hyderabad ITAT ruling
- Comments
- Way forward
- Do you know about Dbriefs?
- Contacts

Executive Summary

- Hyderabad ITAT in its decision rendered in the case of Medplus Health Services Private Limited delete 'deemed-gift' income addition made by Assessing Office (AO) u/s 56(2)(viiia)
- Issues under consideration were as follows:
 - Whether CIT(A) erred in upholding AO's order of making addition u/s 56(2)(viiia) without appreciating the fact that the 'Fair Market Value' (FMV) of the shares on transaction date was negative; and
 - Whether CIT(A) erred in upholding AO's action in not following prescribed rule 11UA while computing disallowance u/s 56(2)(viiia).
- AO adopted higher of the two available prices used for acquiring the shares as FMV and treated the differential price as 'deemed gift' liable to tax u/s 56(2)(viiia).
- Hyderabad ITAT held that where a method has been prescribed by the law for computing the FMV, that method alone shall be followed. Accordingly, provisions of section 56(2)(viiia) were not properly and correctly applied in the assessee's case

Facts

- M/s. Medplus Health Services Private Limited ('assessee') is engaged in the business of wholesale trading of pharmaceuticals, medicines, general stores and running of clinics.
- During FY 2010-11, pursuant to a group restructuring exercise, the assessee took over almost all of the shares of Optival Health Solutions Private Limited ('Optival') from its shareholders. This resulted in the assessee becoming the holding company of Optival.
- Shares of Optival were purchased by the assessee at Re. 1, while some shareholders sold the shares at Rs. 75.49 on the same day
- Assessee purchased shares from Mr Srinivasa Raju and Chintalapati Holdings P. Ltd at Rs. 74.59 per share on 4th March 2011, whereas balance shares were purchased at Re. 1 per share on the same day
- AO held that market rate was Rs.75.49 per share, and since assessee purchased the shares at less than the market price i.e., Re. 1 per share, the transaction attracted provisions of Sec 56(2)(viiia) and thus treated the difference of Rs. 74.49 to be taxable as deemed gift in assessee's hands.

- In response, assessee submitted that FMV has to be calculated in accordance with the provisions of sec. 56(2)(viiia) read with Rules 11UA. Basis this, FMV was determined at a value less than zero and accordingly, assessee submitted the purchase price of Re. 1 to be more than the FMV.
- The AO was further not convinced with the assessee's submission and held that Re. 1 was paid by assessee to its related party to defraud the Revenue and payment of Rs. 75.49 was made to unrelated parties.
CIT(A) upheld AO's order. Aggrieved, assessee preferred an appeal before the Hyderabad ITAT.

Issue before the Hyderabad ITAT

Whether the revenue was correct in invoking provisions of Section 56(2)(viiia) on transfer of equity shares without relying on 11UA computation submitted by the assessee to determine FMV of the shares

Hyderabad ITAT Ruling

- ITAT opined that the AO was justified in examining the applicability of section 56(2)(viiia) to the transaction of transfer of shares as it satisfied all the criteria's prescribed u/s 56(2)(viiia)
- The next step is to arrive at FMV of the shares. Accordingly, the ITAT held that where a method has been prescribed by the legislature, that method alone shall be followed for computation of the FMV. ITAT further held that AO's act of not following the relevant provisions provided under Rule 11UA for computation of the FMV and instead adopting the value of Rs. 75.49/- at which some of the shares have been purchased by the assessee as FMV, was not correct.
- ITAT observed that the legislature in its wisdom has given formulae for computation of the fair market value which cannot be ignored by the authorities below and that AO ought to have mandatorily computed the FMV in accordance with the said provision if he was not satisfied with assessee's working.

- Thus, ruling in favour of the assessee, ITAT opined that AO's stand in adopting a higher FMV was not correct and was thereby satisfied that the provisions of Sec 56(2)(vii) were not properly and correctly applied in assessee's case.

Comments

The ITAT has observed that where a method has been prescribed by the legislature for determination of the FMV, the lower authorities cannot ignore the same and have to mandatorily compute the FMV in accordance with the said provision.

Way forward

This judgement would render to be useful in case of multiple share transfers of a company carried out at the same time with related and unrelated parties at differential prices.

Source: Medplus Health Services P Ltd Vs. ITO [TS-129-ITAT-2016(HYD)]

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Contacts

Ahmedabad

Heritage, 3rd Floor,
Near Gujarat Vidyapith,
Off Ashram Road,
Ahmedabad – 380 014.
Tel: + 91 (079) 2758 2542
Fax: + 91 (079) 2758 2551

Coimbatore

Shanmugha Manram
41, Race Course,
Coimbatore
Tamil Nadu - 641018
Tel: + 91 (0422) 439 2801
Fax: +91 (0422) 222 3615

Kolkata

Bengal Intelligent Park Building Alpha,
1st floor, Block EP and GP Sector V,
Salt Lake Electronics Complex,
Kolkata - 700 091.
Tel : + 91 (033) 6612 1000
Fax : + 91 (033) 6612 1001

Bangalore

Deloitte Centre, Anchorage II,
100/2, Richmond Road,
Bangalore 560 025.
Tel: +91 (080) 6627 6000
Fax: +91 (080) 6627 6010

Delhi/Gurgaon

Building 10,
Tower B, 7th Floor,
DLF Cyber City,
Gurgaon 122 002
Tel : +91 (0124) 679 2000
Fax : + 91 (0124) 679 2012

Mumbai

Indiabulls Finance Centre,
Tower 3, 28th Floor,
Elphinstone Mill Compound,
Senapati Bapat Marg, Elphinstone (W),
Mumbai – 400013
Tel: + 91 (022) 6185 4000
Fax: + 91 (022) 6185 4101

Chennai

No.52, Venkatanarayana Road,
7th Floor, ASV N Ramana Tower,
T-Nagar,
Chennai 600 017.
Tel: +91 (044) 6688 5000
Fax: +91 (044) 6688 5050

Hyderabad

1-8-384 and 385, 3rd Floor,
Gowra Grand S.P.Road,
Begumpet,
Secunderabad – 500 003.
Tel: +91 (040) 6603 2600
Fax: +91 (040) 6603 2714

Pune

106, B-Wing, 7th Floor,
ICC Trade Tower,
Senapati Bapat Road,
Pune – 411 016.
Tel: + 91 (020) 6624 4600
Fax: +91 (020) 6624 4605

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