IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'A' NEW DELHI

BEFORE SHRI G.D. AGRAWAL, HON'BLE PRESIDENT
&
SHRI K. NARASIMHA CHARY, JUDICIAL MEMBER

ITA No.-2189/Del/2018
(Assessment Year : 2014-15)

Agro Portfolio Private Ltd. DSM 609-610, 6th Floor, Shivaji Marg, Najafgarh, New Delhi. **AAJCA1881D**	vs	ITO Ward 1(4) New Delhi.

Assessee by	**Sh. Upvan Gupta, Adv.**
Revenue by	**Sh. Ravi Kant Gupta, Sr. DR**

Date of Hearing	**02.05.2018**
Date of Pronouncement	**16.05.2018**

ORDER

PER SHRI K.NARASIMHA CHARY, J.M.

Aggrieved by the order dated 16.02.2018 in appeal no. 556/16-17 passed by the Ld. Commissioner of Income Tax (Appeals)-I, New Delhi. Assessee preferred this appeal.

2. Facts in brief are that the assessee is a company engaged in the business to acquire by original subscription, tender, purchase, exchange or otherwise hold shares, stocks, debentures, debenture stocks, bonds, obligation, securities, and all kind of investment instruments of every description issued or generated by anybody

corporate, any Government, RBI, Bank, Sovereign-Ruler Commissioners, public body or any authority, and to act as investor, pawners, bargainers, trustees, advertisers, underwriters, brokers, sub brokers factors, manager, issue house, purchaser, seller, transfer agent, investments, consultants, stocks, shares and securities of all kind of description. During the previous year relevant for the assessment year 2014-15, the assessee had allotted 3,15,000 Equity shares of face value of Rs. 10/- each at a premium of Rs. 40/- per share consisting total amount of Rs. 1,26,00,000/-. The said allotment was done by the assessee company in pursuance to provision of section 56(2)(viib) read with Rule 11UA whose fair market value of the share i.e. Rs. 50/- was done on the basis of Discounted Cash Flow Method which was work out by one of the know Merchant Banker i.e. M/s SPA Capital Advisors Ltd.

3. For the assessment year 2014-15, the assessee filed its return of income u/s 139(1) of the Income Tax Act, 1961 (for short referred as the 'Act') on 29.09.2014 declaring a loss of Rs. 53,083/-. Assessment was concluded by order dated 19.12.2016 on a total income at Rs. 1,26,72,917/- and in that process Ld. AO made addition of Rs. 1,27,26,000/- u/s 56(2)(viib) of the Income Tax Act, rejecting the valuation report of the said Merchant Banker i.e. M/s SPA Capital Advisors Ltd. and independently determining the value of Share at Rs. 9.60 and calculating over and above the value of share allotted over Rs. 9.60 i.e. Rs. 40.40 i.e., for deriving the aforesaid amount of Rs. 1,27,26,000/-

multiply no. of shares i.e. 3,15,000 X Rs. 40.40 (diff. of Rs. 50 and Rs. 9.60). The disallowance u/s 56(2)(viib) of the Income Tax Act of Rs. 1,27,26,000/-.

4. Appeal preferred to the Ld. CIT(A) was dismissed by way of impugned order. Hence, the assessee is before in this appeal stating that the AO is not justified in rejecting the valuation reports submitted before the assessee in support of the issue price of the shares to the Ld. AR and Rule 11UA(2) the Ld. AO is not supposed to ignore the option exercised by the assessee and to impose any other method than that adopted by the assessee. In this case, the assessee adopted the DCF Method and determined the FMV of the shares, as such, if it is not agreeable to the AO on the price determined by the Merchant Banker, Ld. AO could have referred the matter to the Income Tax Department Valuation Officer for a determination of price market value of such capital asset.

5. Per contra, Ld. DR submitted that the orders of the authorities below are based on sound reasoning. He submits that the assessee failed to justify their taking the risk free return at 9.04% within two years of their coming into existence and running into losses from the inception. So also the assessee is not justifying in taking the expected return from market at 15.80 which is quite unrealistic on the face of their performance for the initial two years of their business. He submits that BSE 500 return is not available to the assessee. He further submitted that

the assessee is in the financial sector and investing only in its group of companies with a negligible risk, as such, negative beta is applicable to them instead of average beta of one.

6. Further Ld. AO recorded that the cash flow to the firm is the cash left over after taxes and after all reinvestment are met to before interest and principle payments on debt; and the assessee had taken free cash flow to equity value for the year 2013-14 which is in the negative at (0.98) which is similar to the earlier year and the data available over the future years also reflects the negative figures of cash flows. According to the Ld. AO even if we assume for a while that in future the assessee is likely to earn the profits still it will take not less than 3 or 4 years to overturn its fortune to start earning profits. In then circumstances, the figures taken by the assessee on account of risk free return, risk free premium, expected returns from the market, risk free rate and Beta are nowhere nearer to the reality.

7. Basing on the above argument, Ld. DR had taken our attention to the disclaimer clause appended by M/s SPA Capital Advisors Ltd. to their report, and submits that a perusal of the above makes it clear that the valuation of shares is not a realistic one keeping in view the growth and stature of the company and the figures in the valuation report have been cooked up without providing any reliable basis as to how the assumptions took place.

8. Lastly, he submits that in so far as DCF method is concerned it is always possible for the company to decide the proposed value

of the shares first and then travelling back to tailor the figures with the reverse engineering process, to suite their convenience.

9. Ld. DR, therefore, submits that unless and until the assessee provides the evidence justifying the facts and figures provided to the merchant banker with their justification it would not be possible for the authorities below either to consider the merits of the DCF method adopted by the assessee or to make suitable adjustments to the same for correct determination of the share price. However, Ld. CIT(A) recorded in his order at page no. 16 thereof that at appellate stage also the assessee was asked to substantiate the basis of projections in cash flow but the Ld. AR relied on the valuers's report and vehemently argued that the valuer report cannot be disturbed by the AO. By not producing the evidences supporting the figures furnished by the assessee to the valuer for obtaining the report, the assessee did not leave any option to the authorities below to consider the merits of DCF method adopted by the assessee, as such, the authorities are constrained to reject the DCF method which could not be verified in the absence of material. He, therefore, submits that in the facts involved in this case there is no other go for the authorities than to adopt the NAV method.

10. We have gone through the record. As could be seen from the orders of the authorities below the fair market value of the shares was determined by M/s SPA Capital Advisors Ltd. a merchant

banker by adopting the DCF method and the approach is as follows:

Year	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**Perpetuity**
Sources of Funds:						
Pat	-1.95	32.60	34.88	36.98	39.20	
Add: Depreciation	0.00	0.00	0.00	0.00	0.00	-
Change in Net Working capital	-	0.01	0.01	0.02	0.02	-
Change in Cash Flows	-1.95	32.61	34.89	37.00	39.22	
Less Cash Flow from 01.04.13 – 30.09.13	-0.98					
Free Cash Flow to Equity	-0.98	32.61	34.89	37.00	39.22	212.83
Discounting Factor @20.80%	0.91	0.75	0.62	0.52	0.43	0.43
Discounted Cash Flow	-0.89	24.56	21.75	19.10	16.76	90.95
Sum of Discounted Cash Flows	172.24					
Add: Book Value of Non Current Investments	36.17					
Add: Cash & Bank Balance As on 30.09.13	4.12					
Total Value	212.53					
Number of Shares	4.20					
Value Per Share	50.60					

Calculation of Cost of Equity

Particulars	**Values**
Risk free return	9.04%
Risk premium	6.75%
Company Specific Risk	5%
Ke	**20.80%**
Calculation of Risk Premium	
Expected return from market (BSE 500 return since inception)	15.80%
Risk free rate (Zero Coupon Yield as on 30.09.13)	9.04%
Beta (to be on conservative side)	1
Risk Premium	6.75%
Perpetuity Growth rate	2%

11. In so far as the figures relating to cash flow to equity, risk free return, expected return from market and Beta taken by the assessee, the observations of the Ld. AO are as follows:

> "***Cash flow to Equity*** *: The cash flow to the firm is the cash left over after taxes and after all reinvestment needs have been met, but before interest and principle payments on debt. To get to cash flow to the firm, you start with operating earnings, instead of net income, and subtract out taxes paid and reinvestment. The assessee has taken free cash flow to equity value for the year 2013-14 is in negative at 0.98. Same was the case is earlier years. The data available for the future years also reflects negative figures of cash flows. This clearly indicates that the discount rate calculated by the company is nowhere close to the reality.*
>
> ***Risk Free Return:*** *The Risk Free Return (Zero Coupon Yield as on 30.09.13) @ 9.04% taken by a company which has come into existence two years back and since inception is unprofitable is illogical. Even if we took a conservative view the assessee at least would have taken two to three years to overturn its fortune and start earning profit. In view of the above this figure is also not acceptable.*
>
> ***Expected Return from Market:*** *The assessee has taken this figure @ 15.80% which is BSE 500 return since inception. The assessee company was asked to state as why a company newly incorporated and negative earnings since inception has taken BSE 500 figures that too since inception.*
>
> ***Beta:*** *Beta is the measurement of return versus risk. Beta measures the risk of the company relative to the risk of the stock market in general. With greater risk, as measured by a larger variability of returns (Business of operating risk), the company's should have a larger beta. And with greater leverage (higher debt to value ratio) increasing financial risk, the company's stock should also have a larger beta. In the case of the assessee the*

assessee being in financial sector only invest in its group companies having negligible risk and, therefore, should have taken a negative beta instead of average beta of I."

12. A notice u/s 142(1) of the Act was issued to the assessee calling for their remarks on these aspects, which reads as follows:

"1. Please refer to your submission dated 07/09/2016 wherein you have submitted certificate of valuation of shares under rule 11UA. On perusal of the valuation report the following facts have been noticed.

i) In its valuation report M/s SPA Capital Advisors Ltd. has given a disclaimer as under: "In preparing the Final Report, SPA has relied upon and assumed, ***without independent verification, the truthfulness, accuracy and completeness of the information and the financial data provided by the company,*** *SPA has therefore relied upon all specific information as received* ***and declines any responsibility should the results presented be affected by thelack of completeness or truthfulness of such information****."*
From perusal of the report it appears that the valuation of shares is not realistic keeping in view the growth and stature of your company. Further, in the valuation report only figures have been put up without giving reasons as to how these assumptions have been made.

ii) In the DCF method first step is to forecast expected cash flow based on assumptions regarding the company's revenue growth rate, net operating profit margin, income tax rate, fixed investment requirement, and incremental working capital requirement. The revenue growth rate as well as the net profit margin of your Company, since inception, is negative and you have been carrying forward business losses. Even in the subsequent years, for which data is available, you have incurred losses (loss ofRs. 53083/- (AY 2014-15) and Rs. 1,00,384/- (AY 2015-16). However, as per the computation of valuation, the free cash flow to equity figures are -0.98 (2013-14), 32.61 (2014-15), 34.89 (2015-16), 37.00 (2016-17), 39.22 (2017-18) which are unrealistic.
You are also requested to submit actual free cash flow (FCF) for the AY 2014-15, 2015-16 & 2016-17 till date)

iii) Similarly with regard to calculation of Cost of Capital, it is requested to clarify whether weighted average has *been taken or otherwise. Further use of BSE 500 return data in your case is uncalled for. All your investments are in the associates company only and you must have the data of their year on year growth rate to calculate the actual return in your case. Also BSE 500 return data since inception is very unusal. Practically for assumption purpose this is a very long period for a company which is incorporated a few years back. Therefore, you are requested to take the realistic figure as deduced from your associate company investments. Further, you are having investments in your associates so the risk factor should be at a very low side. Therefore, you are requested to clarify the basis relying upon the company specific risk has been calculated at5%. Similarly Beta figure of I and Risk premium of 6.75 may also be justified.*

iv) Also you have taken a discounting factor @ 20.80% for a company whose returns are continuously in negative which is an unrealistic approach to calculate the value of shares. In view of the above you are also requested to give details of values which have been taken to arrive at a discounting figure @ 20.8% and also the basis behind such assumption for a company whose return have consistently been negative. Also, whether sector specific study has been carried out to reach the rate of return of growth. If, yes give a copy of the same.

v) Further, you are requested to submit Financial statement of six months ended on September 30, 2013.

In view of the above, you are requested to submit the details and explanations called for above and to explains as to why the DCF method of valuation employed by you for valuation of shares under Rule 11UA should not be rejected and, therefore, the book value method as per RULE 11UA (2)(a) should not be taken for the purpose of Section 56(2)(viib) of the I.T. Act, 1961."

13. Having received the above detailed notice, the assessee could not bring anything on record to satisfy the queries of the Ld. AO, necessitating the AO to issue another notice u/s 144/142(1), whereunder the Ld. AO calculated the fair market value by following the NAV, at Rs. 6.0 as against Rs. 50.60 adopted by the assessee. Assessment order further reveals that the assessee did

not respond to this notice also, as such, under best judgment method Ld. AO concluded the assessment by making an addition of Rs. 1,27,26,000/- by taking the value of the share at Rs. 9.60, as against 50.60 adopted by the assessee.

14. Even before the Ld.CIT(A) also, as recorded by the Ld. CIT(A) the assessee did not produce any evidence to substantiate the basis of projections in cash flow but relied on the valuer's report vehemently contending that such a report cannot be disturbed by the Ld. AO. At no point of time tried to explain where did the Ld. AO went wrong in his comments on the figures reflected in the above valuation report of the expert.

15. In these circumstances, we are unable to accept the contentions of the assessee that in view of the provisions under section 56(2)(viib) of the Act read with Rule 11UA(2) of the Rules the Ld. AO had no jurisdiction to adopt a different method than the one adopted by the assessee, and if for any reason the AO has any doubt recording such valuation report and does not agree with the same is bound to make a reference to the Income tax Department Valuation Officer to determine the fair market value of such capital asset. This is so because unless and until the assessee produces the evidences to substantiate the basis of projections in cash flow and provides reasonable connectivity between those projections in cash flow with the reality evidences by the material, it is not possible even for the Departmental Valuation Officer to conduct any exercise of verification of the

acceptability of the value determine by the merchant banker. This is more particularly in view of the long disclaimer appended by the merchant banker at page no. 16 & 17 of the paper book which clearly establishes that no independent enquiry is caused by merchant banker to verify the truth or otherwise the figures furnished by the assessee at least on test basis. The merchant bankers solely relied upon an assumed without independent verification, the truthfulness accuracy and completeness of the information and the financial data provided by the company. A perusal of this long disclaimer clearly shows that the merchant banker did not do anything reflecting their expertise, except mere applying the formula to the data provided by the assessee. We, therefore, are unable to brush aside the contention of the Revenue that the possibility of tailoring the data by applying the reverse engineering to the pre determined conclusions.

16. For all these reasons, we are of the considered opinion that there has not been any possibility of verifying the correctness or otherwise of the data supplied by the assessee to the merchant banker, in the absence of which the correctness of the result of DCF method cannot be verified. This left no option to the AO but to reject the DCF method and to go by NAV method to determine the FMV of the shares. Without such evidence, it serves no purpose even if the matter is referred to the Department's Valuation Officer. We, therefore, do not find any illegality or irregularity in the approach of conclusions are by the authorities

below. While confirming the same, we dismissed the appeal as *devoid* of merits.

17. In the result, the appeal of the assessee is dismissed.

Order pronounced in the open court on 16.05.2018

Sd/-
(G.D. AGRAWAL)
PRESIDENT

Sd/-
(K. NARSIMHA CHARY)
JUDICIAL MEMBER

Dated: 16.05.2018
*Kavita Arora

Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

TRUE COPY

ASSISTANT REGISTRAR
ITAT NEW DELHI

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