

THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD “B” BENCH
(Conducted Through Virtual Court)
Before: Ms. Annapurna Gupta, Accountant Member
And Shri Siddhartha Nautiyal, Judicial Member

ITA No. 1541/Ahd/2017
Assessment Year 2013-14

Shri Jigar Jashwantlal Shah, 3, Hariharashray Bungalows, 100 Ft, Shilaj Road, Thaltej, Ahmedabad-380054 PAN: ADAPS7037E (Appellant)	Vs	ACIT, Circle-2(1)(1), Ahmedabad (Respondent)
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ITA No. 1643/Ahd/2017
Assessment Year 2013-14

ACIT, Circle-2(1)(2), Ahmedabad (Appellant)	Vs	Shri Jigar Jashwantlal Shah, 3, Hariharashray Bungalows, 100 Ft, Shilaj Road, Thaltej, Ahmedabad-380054 PAN: ADAPS7037E (Respondent)
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Assessee by: Shri S.N. Soparkar, A.R.
Revenue by: Shri Shibaji Simlai, Sr. D.R.

Date of hearing : 01-03-2022
Date of pronouncement : 06-05-2022

आदेश/ORDER

PER : SIDDHARTHA NAUTIYAL, JUDICIAL MEMBER:-

These two appeals filed by assessee and revenue against the order of the Id. Commissioner of Income Tax (Appeals)-2, Ahmedabad in Appeal no. CIT(A)-2/39/AC. Cir. 2(1)(2)/2016-17 vide order dated 21/04/2017 passed for the assessment year 2013-14.

ITA No. 1541/Ahd2017 filed by assessee

2. The assessee has raised following grounds of appeal:-

“1 Ld. CIT (A) erred in law and on facts confirming reassessment proceedings initiated by AO without jurisdiction in absence of 'reasons to believe' and escapement of any income that deserves to be quashed.

2 Ld. CIT (A) erred in law and on facts confirming addition in respect of additional 82,200 shares allotted to appellant due to renouncement of rights by wife & father in favour of the appellant held as disproportionate allotment by AO without adequate consideration u/s 56(2)(vii) of the Act.

3 Ld. CIT (A) erred in law and on facts confirming addition of income made by AO on account of inadequate consideration on 14,800 additional right shares allotted to the appellant u/s 56(2)(vii)(c) of the Act.

Ld. CIT (A) erred in law and on facts confirming Rs. 1,89,68,350/- out of total addition by AO considering allotment of 97,000 (82,200 + 14,800) shares as disproportionate allotment.

5 Without prejudice to the above grounds, Id. CIT (A) erred in law and on facts making erroneous calculation @ Rs.195.55 per share for 97,000 additional shares confirming addition of Rs. 1, 89, 68, 350/-.

6 Levy of interest u/s 234 A/B/C & D of the Act is not justified.

7. *Initiation of penalty proceedings u/s 271(1) (c) of the Act is not justified.*

The appellant craves leave to add, amend, alter, edit, delete, modify or change all or any of the grounds of appeal at the time of or before the hearing of the appeal.”

ITA No. 1643/Ahd2017 filed by Revenue

3. The Revenue has raised following grounds of appeal:-

“1. The Ld.CIT(A) has erred in law and on facts in deleting the addition u/s 56(2)(vii)(c) in respect of the additional shares allotted to the assessee .

2. The Ld.CIT(A) has erred' in law and on facts in adopting the valuation of shares at Rs 205 per share instead of Rs 255 per share determined by the AO as per Rule 11UA(1)(c)(b) in respect of the additional shares allotted to the assessee .

3. On the facts and in the circumstances of the case, the Ld. CIT(A) ought to have upheld the order of the Assessing Officer.

4. It is, therefore, prayed that the order of the Ld. CIT(A) may be set aside and that of the Assessing Officer may be restored to the above extent.

5. The appellant craves leave to amend or alter any ground or add a new ground, which may be necessary.”

4. The facts of this case are that the assessee filed his return of income for A Y 2013-14 declaring total income of Rs. 86,94,247/- . The return of the assessee was processed u/s 143(1) of the Act. Thereafter, during the

course of assessment proceedings of M/s Kintechsynergy Limited, it was noticed that the assessee was receiving salary in the capacity of a director of M/s KintechSynergy Limited. Further, it was noticed that the assessee was issued 2,00,000 rights shares at face value of Rs. 10/- in M/s Kintech Synergy Limited. The Ld. Assessing Officer issued notice u/s 148 of the Act on the ground that aggregate FMV of shares allotted to the assessee at Rs. 5,10,00,000/- far exceeded the consideration amount of Rs. 20,00,000/- paid for receipt of shares and as per provisions of section 56(2) of the Act, the same should have been taxed in the hands of the assessee. Accordingly, the Ld. Assessing Officer held that the differential amount of Rs. 4,90,00,000/- has escaped assessment in hands of the assessee. The assessee challenged the proposed addition, but the Ld. Assessing Officer held that the above sum of Rs. 4,90,00,000/- is taxable in hands of the assessee. The Ld. Assessing Officer while passing the order held as under:

“Shareholding of Shri Jigar J Shah in AY 12-13 was 27.90% prior to receipt of 2.00.000 shares.

Shareholding of Shri Jigar J Shah in AY 13-14 was 53.22% after receipt of 2.00.000 shares.

It needs to be appreciated that though the medium of issuance of additional shares issued at below FMV substantial controlling interest in the company / business could be passed on to. Hence, the provision of taxing section 56(2)(vii) bringing to tax the shortfall in consideration over the FMV is on firm, cogent and sound footing.

On perusal of above comparison of shareholding percentage of Jigar J. Shah, it can be observed that the assessee not only 'quantitatively' gained shares of Kintech Synergy Ltd. at a value far lesser than the FMV of the shares (Rs.4.90,00,000), but also, "qualitatively" gained in terms of increase in his shareholding percentage.

The assessee here became the majority shareholder holding 53.22% of total shares after receipt of shares in AY 13-14 as compared to shareholding percentage of 27.90% in AY 12-13.

With forgoing mention of facts of the case and interpretation of the statute, below is the rebuttal of submission dated 21/03/2016 filed by assessee on each and every point:-

I. Property:- As recorded in reasons for reopening for the purposes of section 56(2)(vii), the term 'property' includes "shares and securities" within its ambit. Accordingly, additional shares i.e. issue of shares to existing shareholders below the market value, would qualify as "property". Shares are movable property and they become existent on allotment.

II. Receipt / Receives- The assessee acquired the right to acquire additional shares at the time of passing of resolution, the receipt of property happened at the time of allotment of shares. This was also the date when property came into existence. Allotment of shares is the event of receipt of property. As per the Supreme Court decision, the shares are 'created' by the exercise of allotment. So on allotment, the shares become 'existent in hands of the allottee, and therefore, it is legally right and unlawful to say that he "receives" movable property at that time.

III. Transfer vs. Receives- Correlating the term "receipt" as synonymous to 'transfer' is inconsistent with the unambiguous and clear intent conveyed by the literal regarding of the Gift Tax provision. If the scope of the term "receipt" is restricted to cases of "transfer", the same would be inconsistent with the unambiguous language of the Gift Tax provision "Receipt" is of wide import and includes acquisition by modes other than by way or "transfer". "Receipt" as envisaged under the Gift Tax provision, accordingly, includes allotment of "additional shares".

IV. Qualitative and Quantitative gain- The subject matter of taxation is always "income". There must be a "gain" (in a real sense) in the hands of the assessee - so as to hold that "income has resulted to him and thereby, tax is attracted as a statutory consequence. A "gain is conceivable when some enrichment results into the assessee from a transaction. In short, there must be betterment in the wealth position of the assessee by the transaction.

This proposition is also manifest from the reading of section 56.

Section 56(1) 'Income of every kin which is not to be excluded from the total income under this Act shall be chargeable to income tax under the head "income from other sources' — if it is not charged to income tax under any head specified in section 14, item A to E'

Section 56(2) - "In particular and without prejudice to the generality of the provision of sub-clause (1), the following incomes shall be charged to income tax under the head "income from other sources" namely....." Section 56 thus clearly reiterates the law that what are chargeable to tax under its provision is items of 'income nature'.

The concept of 'income" must be understood both in its qualitative sense and quantitative sense.

In a qualitative sense, it flaunts the characteristic of a 'gain' resulting to the assessee. In other words, the assessee must become monetarily better off by the transaction of receipt of property.

In the quantitative sense, it is a 'measure' of the gain earned in terms of money.

It is the "income' in its qualitative sense that attracts the charge of income tax through the charging section 4 of the Income Tax Act. Once the income is so found chargeable, the next step is to get it measured under the computational provisions pertaining to each head of the income. This is the determination of income in its quantitative sense.

v. Disproportionate allotment- In the context of Section 56(2)(vii)(c), the value of the property which an assessee receives is to be evaluated by comparing the value of the property held by the assessee immediately before the receipt and the value of the property immediately after the receipt and only the incremental value should be considered to be the .value of the property received. A higher than proportionate or a non-uniform -allotment and the consequential higher than proportionate allotment to the purchasing shareholder, who exercises the rights purchased by him, results in receipt by the shareholder of property in the form of shares and securities (at a discount) will attract Section 56(2)(vii)(c).

A higher than proportionate or a non - uniform / disproportionate allotment of additional / bonus shares stands on a different footing. To the extent of disproportionate allotment, the Gift Tax provision stands attracted.

A proportionate offer can, in certain circumstances, result in a disproportionate allotment. One of the ways could be selective basis, i.e. where some shareholders abstain from exercising their rights (wholly or in part) and, accordingly, transfer additional shares to other shareholder. To illustrate, two shareholders equally hold (50% each) in a company. An additional issue in the ratio 1:1, abstained by one shareholder results in the other having a 2/3rd holding. A higher proportion of additional shares yield a more skewed holding in favour of the resulting dominant shareholder. This possibly results in divesting the controlling interest in a company to another shareholder at a consideration less than FMV.

VI. This office also relies on the judgment of Sudhir Menon HUF vs. ACIT -Mumbai ITAT - 'A' Bench - ITA No.4887/Mum/2013 dated 12-3-2014 for Assessment Year 2010-11.

VII. In view of above discussion and position of legislation, on account of disproportionate allotment of shares - the assessee has 'gained' "qualitatively" with substantial controlling interest of 53.22% in AY 13-14 as compared to 27.90% in immediately preceding year AY 12-13 and 'quantitatively' with Rs.4,90,00,000 to be charged as income as per section 56(2)(vii) of the Act. Accordingly a sum of Rs. 4,90,00,000/- received by way disproportionate allotment of shares is added as income u/s. 56(2)(viii) to the total income of the assessee."

5. In appeal before, Ld. CIT(Appeals), on merits, the assessee submitted that the Ld. Assessing Officer failed to appreciate that the shares were not 'received' by transfer, but allotted by way of rights allotment and hence s. 56(2)(vii) of the Act cannot be invoked. The assessee further submitted that the Ld. Assessing Officer erroneously held that rights share allotment was disproportionate. The assessee further challenged the valuation of shares done by the Ld. Assessing Officer at Rs. 255/- per share as being excessive. The assessee submitted that the Ld. Assessing Officer has not considered the

Supreme Court decision in the case of Khoday Distillers 307 ITR 312 (SC) wherein the Hon'ble Supreme Court held that the word 'allotment' indicates creation of shares by appropriation out of the unappropriated share capital to a particular person and such creation would not amount to transfer, and hence s. 56(2)(vii) of the Act cannot be invoked. The Ld. CIT(Appeals) gave part relief to the assessee in respect of allotment made proportionate to the current shareholding of the assessee (of 1,03,000 shares) relying on the decision of Sudhir Menon (HUF) v. ACIT 45 Taxmann.com 176 , but in respect of additional shares received by the assessee on renouncement of rights shares by wife and father of the assessee amounting to 82,200 shares and also 14,800 allotted the assessee as a result of third party shareholders renouncing their rights shares in favour of the assessee, he upheld the disallowance on the ground that the allotment of additional shares was disproportionate to present shareholding of the assessee and hence provisions of s. 56(2)(vii) of the Act are applicable. Ld. CIT(Appeals) also gave part relief on the valuation of shares and reduced the same to Rs. 205.55 per share from Rs. 255 per share as worked out by the Ld. Assessing Officer. The Ld. CIT(Appeals) while allowing part relief observed as under:

“3.3 I have carefully considered the facts of the case, assessment order submission of the appellant. The AO has made the addition of Rs.4,90,00,000/- invoking the provisions of section 56(2)(vii) of the I. T. Act, 1961 in respect of the disproportionate allotment of additional shares issued by the company namely; Kintech Synergy Limited to the appellant. The AO has not specified the sub-section or clause of section 56(2) (vii) of the I. T. Act, 1961. However, apparently she intends to invoke the provisions of section 56(2) (vii) (c) of the I. T. Act, 1961. It has been noticed that the appellant was a director in the aforesaid company and the company has issued 2 lac shares of face value of Rs.10/- at par in the month of March, 2013. As per AO, the

fair market value of such shares were at Rs.5.10 crores which was exceeding to the consideration of Rs.20,00,000/- on the 2 lac shares of face value for Rs.10/- per share. Since the shares have been received by the appellant at the value lesser than FMV of the shares, the AO observed that by issuing these additional shares, the assessee has become the majority share holder at 53.22% of total shares as compared to its earlier shareholding at 27.90% in A. Y. 2012-13. Thus, there was disproportionate allotment of shares and for all the additional shares the differential amount of Rs.4.90 crore has been added by the AO with the discussion in Para 4 of the assessment order.

*3.4. Having considered the facts and submissions, it has been noticed that earlier the appellant had the shareholding of 1,03,000 shares which was 27.90% of the entire shareholding. Further his wife and father were holding 82,200 shares. During the year under consideration, the appellant has been allotted additional shares of 1,03,000 at the face value of Rs. 10/- by the company as per his proportionate shareholding. Simultaneously, the other share holders like wife and father of appellant who were also eligible for the additional shares on proportionate basis at 82,200 have renounced their right of entitlement of the additional shares in favour of the appellant and consequently, the appellant has been allotted more additional shares of 1,85,200 (1,03,300+ 82,200) in respect of himself and per the renouncement. In other words, the appellant has been allotted the total additional shares of 1,85,200 (1,03,000 + 82,200) in respect of himself and renouncement in his favour by his wife and father. Since the appellant has been allotted the additional shares of 1,03,000 as per his proportionate holding for which the provisions of section 56(2) fvii) are not applicable and no addition in this regard could be made as per the express provisions of the said section and the decision of Hon'ble ITAT, Mumbai 'A' Bench in the case of **Sudhir Menon (HUF) Vs. ACIT, Mumbai [2014] 45 Taxmann.conrv;i76 dated 12/03/2014** which is discussed in the subsequent paras. The Honourable ITAT has held that the appellant's case is limited to right shares and to the extent the shares subscribed to are right shares i.e. allotted pro rata on the basis of existing share holding (as on a cut-off date). The provisions though per se applicable does not operate adversely. Hence, the Honourable ITAT has held that no income on this account in the hands of the appellant on the*

ground of inadequate consideration could be taxed. For ready reference, the head note of the judgment is reproduced as under:-

"IT : Where additional shares of a company were allotted pro rata to shareholders including assessee based on their existing shareholding, there was no scope for any property being received on said allotment of shares and, consequently provisions of section 56(2)(vii)(c) did not apply to difference in book value and face value of additional shares."

3.5. In view of the aforesaid discussion and the submissions made by the appellant, the addition made by the AO in respect of the income due to inadequate consideration with reference to the pro rata allotment of additional shares of 1,03,000 shares is uncalled for and hence the same is **deleted.**"

3.6. Now, with regard to the additional shares of 82,200 on account of renouncement of the rights by wife and father of the appellant, the addition made by the AO on principle is found correct and justified for the reason that this allotment of additional shares was disproportionate allotment in the hands of the appellant and for which the provisions of section 56(2) (vii) are applicable and addition under this head made by the AO is **confirmed.**

3.7. Further, the appellant has also been allotted additional shares at 14,800 over and above to its proportionate allotment of 1,03,000 shares and renouncement rights of 82,200 shares. In other words, the appellant has been allotted 2 lac additional shares in total. Thus, the provisions of section 56(2) (vii) (c) will also be applicable on this additional shares of 14,800 shares which were disproportionate allotment in the hands of appellant for which the income has to be computed as per the provisions of the I. T. Act.

3.8. It has been noticed that the AO has derived the value @ 255 per share to arrive at the inadequate consideration, but it has been noticed that as per the Rule 11UA(1)(C)(b), the fair market value per share on the date of allotment considering the book value as on 31/03/2012 and the further consideration received on account of issuance of additional shares comes to Rs.205.55 per share. In other words, the book value of the assets comes to Rs.1 1,70,17,4187- (including the book value of assets as on 31/03/2012 + Rs.20 lacs)

consideration received towards additional shares / by 5,69,300 shares (includes 2 lacs additional shares).

*3.9. In view of the above, the addition of income for the total 97,000 additional shares (82,200 + 14,800) @ Rs.195.55 (Rs.205.55 - Rs.10) works out to Rs. 1,89,68,3507- and the same is found justified and hence **confirm** Further relief of Rs.3,00,31,6507- is granted to the appellant.”*

6. Before us, both the assessee and Department are in appeal against the order by Ld. CIT(Appeals). The Ld. Counsel for the assessee reiterated the arguments taken before Ld. CIT(Appeals) to the effect that in the instant set of facts, provisions of s. 56(2)(vii) of the Act cannot be invoked. He submitted that Ld. CIT(Appeals) erred in and in facts in not applying the ratio of decision of Khoday Distillers 307 ITR 312 (SC) wherein the Hon'ble Supreme Court held that the words 'allotment of shares' have been used to indicate the creation of shares by appropriation out of the unappropriated share capital to a particular person. There is a difference between issue of a share to a subscriber and the purchase of a share from an existing shareholder. The first case is that of creation, whereas the second case is that of transfer of chose in action. In the present case, when the assessee is allotted shares, applying the ratio of above ruling, such allotment was not a transfer and hence provisions of s. 56(2)(vii) of the Act cannot be invoked. He further submitted that s. 56(2)(vii) of the Act contemplates transfer of 'asset' in favour of the assessee, but in so far as the company is concerned, shares are 'liability' of the company and hence incapable of being transferred by company in the first place in favour of the assessee. He further submitted that that so far as additional allotment of 82,200 shares are concerned, the same have been renounced in favour of assessee by

immediate family members, who have been excluded from purview of section 56(2)(vii) of the Act altogether. He placed reliance on several judicial precedents in support of his contention. In response, the Ld. DR challenged the relief granted by Ld. CIT(Appeals) in respect of proportionate allotment stating that since shares have been allocated below FMV, the provisions of s. 56(2)(vii) of the Act are clearly applicable since there has been escapement of income. He further submitted that the reliance on decision of Sudhir Menon *supra* by Ld. CIT(Appeals), on the basis of which relief has been granted to the assessee, is misplaced, since Department is in appeal against the decision before the Bombay High Court. The Ld. DR also challenged the revised working of valuation accepted by Ld. CIT(Appeals) and placed reliance on the assessment order as regards the working of valuation of shares.

7. We have heard the rival contentions and perused the material on record. We have the following issues for consideration before us. First is whether section 56(2)(vii)(c) of the Act can be invoked in respect of allocation of 1,03,000 rights shares allotted to the assessee proportionate to his shareholding in the company. Secondly, whether section 56(2)(vii)(c) of the Act can be invoked in respect of additional 82,200 shares received by the assessee since the assessee's wife and father did not exercise the rights issue and renounced the same in favour of the assessee. Third, whether section 56(2)(vii)(c) of the Act can be invoked in respect of 14,800 allotted the assessee as a result of third party shareholders renouncing their right to apply for rights shares in favour of the assessee. Fourth, whether Ld.

CIT(Appeals) erred in accepting the valuation of shares proposed by the assessee.

8. Before, taking up these issues, it would be pertinent to first deal with the challenge to issuance of notice u/s 148 of the Act by the assessee. In our view, Ld. CIT(Appeals) has not erred in facts and in law in upholding the issuance of notice u/s 148 of the Act. The return of the assessee was processed u/s 143(1) of the Act and no regular assessment took place to consider the issue of taxability of income in respect of allotment of rights shares in favour the assessee. The Ld. Assessing Officer issued notice within four years from end of assessment year involved. The Ld. Assessing Officer, in our view, had substantive reasons to believe that income had escaped assessment on account of disproportionate allocation of shares in favour of the assessee. The case was reopened after following due process of law and reasons were furnished to the assessee and objections to the issuance of notice filed by the assessee were disposed by way of a speaking order on 14-03-2016. Since, the regular scrutiny assessment did not take place, there is no question of change of opinion. Therefore, in our considered view, the notice issued u/s 148 of the Act has been issued after due application of mind and following due process of law and hence we find no infirmity in order of Ld. CIT(Appeals) confirming the validity of issuance of notice u/s 148 of the Act.

9. In addition, before discussing the issues for consideration as enumerated, it would be important to first discuss whether for invoking section 56(2)(vii)(c) of the Act, the asset (shares in the instant case) in

question should be ‘existence’ and should be capable of being ‘transferred’ to the recipient. The argument put forth before us is that there is a difference between ‘issuance’ of a share to a subscriber and the ‘purchase’ of a share from an existing shareholder. The first case is that of creation of an asset, whereas the second case is that of transfer of chose in action. It has been argued that only the latter case can fall within the ambit of s. 56(2)(vii)(c) of the Act, while the former case falls outside the ambit of s.56(2)(vii)(c) of the Act, which contemplates ‘transfer’ of an asset in favour of the recipient, for which the asset must be existence for it to be transferred. It has been argued, by placing reliance on the case of Khoday Distilleries *supra* that the word ‘allotment’ indicates creation of shares by appropriation out of the unappropriated share capital to a particular person and such creation would not amount to ‘transfer’ which is a *sine qua non* for invoking section 56(2)(vii)(c), i.e. there must be in existence shares capable of being ‘transferred’ for such provision to apply. We are however, not inclined to agree with the argument put forth before us. On plain reading of section 56(2)(vii)(c) of the Act, the term used is ‘receives’ and the said term cannot in our view be restricted to receipt by way of ‘transfer’ alone. The section does not indicate anything towards such a restricted interpretation, when using the term ‘receives’. Further, 56(2)(vii)(c) nowhere speaks of the word ‘transfer’ or ‘receives by way of transfer’, so as to give a restricted interpretation to section 56(2)(vii)(c) of the Act. This issue has been succinctly elaborated in the case of Sudhir Menon *supra*, in the following words:

“The argument seeks to support the contention that the transaction in order to qualify as valid in law has to be a case of transfer in-as-

much as the consideration implies price, so that the word 'receipt' occurring in section 56(2)(vii) has to be read as a synonym for or equated with 'purchase' or 'transfer'. The shares under question being not acquired through transfer, the transactions falls outside the ambit of section 56(2)(vii). We are completely unimpressed. The argument, attractive on its face, fails miserably the moment the nature of the transaction, i.e., the allotment of the shares (through which the relevant shares stand acquired or received), upon which only the shares come into existence and are received by the allottee thereof, is clarified. The same has been subject to dilation and elucidation by the apex court inter alia in Shree Gopal & Co. (supra) and Khoday Distilleries Ltd. (supra) relied upon by the parties themselves before us. As stated explicitly in the former case, a share is a chose in action. A chose in action implies the existence of some person entitled to the rights, which are rights in action as distinct from rights in possession, and, until the share is issued, no such person exists. A share does not exist prior to its allotment, and in that sense comes into existence only on its allotment. Allotment of a share is only the appropriation of the authorized share capital, being un-appropriated, to a particular person. In nutshell, the difference between the issue of a share to a subscriber and a purchase of a share from an existing shareholder is the difference between the creation and transfer of a chose in action (refer pgs.865, 866). How could, therefore, purchase be equated with allotment? In fact, the purchase or transfer implies existence of a property, while the shares, where out of un-appropriated capital, come into existence only on their allotment. It becomes, thus, in the

context of the provision, completely irrelevant and of no consequence that the shares in the issuing company are not its property, and that it does not become, therefore, any poorer as a result of the allotment of shares therein. 'Receipt' is a word or term of wide import, and would include acquisition of the subject matter of receipt - defined capital assets in the present context, by modes other than by way of transfer as well. We find no reason to limit or restrict the scope of the word 'receipt' in the provision to cases of 'transfer' only. Doing so would not only amount to reading down the provision, which the tribunal is even otherwise not competent to, being not a court of law, but reading it in a manner totally inconsistent with the unambiguous language and the clear intent (of the Legislature) conveyed thereby, but also its context as well as the drift of section, in complete violence thereto.

10. Now we shall take up the issue of whether section 56(2)(vii)(c) of the Act can be invoked in respect of allocation of 1,03,000 rights shares allotted to the assessee below FMV, proportionate to his shareholding in the company. In our view, once the shares have been issued proportionate to existing shareholding, 56(2)(vii)(c) of the Act cannot be invoked. This issue has been dealt with and various Tribunals who have consistently taken the position that allocation of rights share proportionate to current shareholding would not attract provisions of section 56(2)(vii)(c) of the Act. The Mumbai ITAT in the case of **Sudhir Menon HUF v. Asstt. CIT [2014] 45 taxmann.com 176/148 ITD 260** following the Judgment of the Hon'ble Supreme Court in the case of Miss. Dhun Dadabhoy Kapadia v. CIT [1967]

63 ITR 651 (SC) and Hon'ble Bombay High Court in the case of H. Holck Larsen v. CIT [1972] 85 ITR 285 (Bom) held that as long as there is no disproportional allotment of shares, there was no scope for any property being received by the tax payer as there was only an apportionment of the value of the existing shareholder over a larger number of shares, and hence no addition u/s 56(2)(vii)(c) of the Act would arise. If the shares are allotted strictly on proportionate basis based on existing shareholding, then though the provisions *per se* are applicable, but will not operate adversely. This is because the gain accruing on allotment of fresh shares will be offset by the loss in value of existing shares. The ITAT Jaipur in the case of **DCIT v. Smt. Veena Goyal [2020] 119 taxmann.com 362 (Jaipur - Trib.)** held that where additional shares were allotted to all shareholders of company in proportion to existing shareholding of shareholder in company and after allotment of additional shares, shareholding percentage of assessee in company remained same and average value per share had also reduced and no gain had arisen in hands of assessee, provisions of section 56(2)(vii)(c) would not be applicable. Again, the Mumbai ITAT in the case of **ITO v. Rajeev Ratanlal Tulshyan [2022] 136 taxmann.com 42 (Mumbai - Trib.)** held that where shares of a company were allotted proportionately to assessee shareholder based on its existing shareholding, there was no scope for any property being received on said allotment of shares and, consequently, provisions of section 56(2)(vii)(c) did not apply to difference in book value and face value of such shares allotted. Respectfully, following the above decisions, and for the reasons cited above. we are of the view that provisions of section 56(2)(vii)(c) do not apply in respect of allocation of

1,03,000 rights shares allotted to the assessee proportionate to his shareholding in the company.

11. Now, we shall deal with the issue of whether section 56(2)(vii)(c) of the Act can be invoked in respect of additional 82,200 shares received by the assessee since the assessee's wife and father did not exercise the rights issue and renounced the right in favour of the assessee. It is a well settled principle of law that what cannot be done directly cannot be done indirectly as well. Had the wife and father of the assessee directly transferred their rights shareholding in favour of the assessee, provisions of 56(2)(vii)(c) of the Act could not have been invoked since wife/ father are falling within the definition of 'relatives', which are excluded from within the purview of operation of section 56(2)(vii)(c) of the Act. Consequently, such renunciation of rights shares, by way of not exercising the right to subscribe to them in favour of the assessee, in our view, would not attract the provisions of section 56(2)(vii)(c) of the Act. The Vishakhapatnam ITAT in the case of **Kumar Pappu Singh v ITO [2019] 101 taxmann.com 122 (Visakhapatnam - Trib.)** held that since transaction of transfer of shares was within family and close relatives, proviso to section 56(2)(vii)(c) could not be applied for taxing income under head 'income from other sources'. Again, the Vishakhapatnam ITAT in the case of **ACIT Y.Venkanna Choudary[2019] 112 taxmann.com 71 (Visakhapatnam - Trib.)** held that where prior to allotment of shares of company to assessee, there were only two shareholders, viz., assessee and his brother, and whatever excess benefit was passed on to assessee was out of shareholding held by his brother, provisions of section 56(2)(viii)(c)(ii) would not apply. Considering the

above, we are of the considered view that section 56(2)(vii)(c) of the Act cannot be invoked in respect of additional 82,200 shares received by the assessee, on account of renunciation of rights issue the by assessee's wife and father in favour of the assessee.

12. Now, on the issue of whether section 56(2)(vii)(c) of the Act can be invoked in respect of 14,800 allotted to the assessee as a result of third party shareholders declining to apply for rights shares in favour of the assessee, the issue for consideration is whether in the instant facts it can be concluded whether there has been disproportionate allotment of shares in favour of the assessee, in which case the position, in our considered view is clear that section 56(2)(vii)(c) of the Act can be invoked. The Ld. DR has relied on observations of the Ld. Assessing Officer in the assessment order wherein he has observed that the assessee has gained both quantitatively as well as qualitatively, and as a result of such renunciation, his shareholding in the company has increased from 29.90% to 53.22%, thereby giving him the controlling interest in the company. Thereby, there has been a disproportionate allotment of rights shares in favour of the assessee. We are of the considered view that renunciation of rights shares by third party shareholders in favour of the assessee, allowing the assessee to gain controlling interest has resulted in disproportionate allocation of rights shares in favour of the assessee and therefore, in respect of these shares, section 56(2)(vii)(c) of the Act shall apply, and income would taxable in the hands of the assessee. It would have been a different matter had the other parties not exercised their right of subscription to these rights shares, resulting in higher or controlling shareholding resulting in hands of the

assessee. That, in our view, would not be disproportionate allocation, since the shareholders were allocated shares in proportion to their shareholding and only because some shareholders decided not to subscribe to rights shares offered to them in proportion to their shareholding, this itself would not make the allocation disproportionate, even if by way of non-exercise of rights, the assessee's shareholding has substantially increased as compared to other shareholders. However, in the instant case, renunciation of rights in favour of the assessee by third party (unrelated shareholders) does lead to disproportionate allocation in favour of the assessee, thereby leading to invocation of section 56(2)(vii)(c) of the Act. The Hon'ble ITAT in the case of Sudhir Menon (*supra*), Smt Veena Goyal (*supra*) and Rajeev Ratanlal Tulshyan (*supra*) have upheld the principle that section 56(2)(vii)(c) of the Act cannot be invoked only in the event the allotment of shares is not disproportionate, but in case allocation is disproportionate, section 56(2)(vii)(c) of the Act would come into operation. Accordingly, in our view, section 56(2)(vii)(c) of the Act would apply in relation to 14,800 allotted the assessee as a result of third party shareholders renouncing their rights shares in favour of the assessee.

13. The fourth issue for our consideration is whether Ld. CIT(Appeals) erred in reducing the valuation of shares to Rs. 205.55 per share by computing the FMV per share on date of allotment taking into consideration the book value as on 31-03-2012 and adding further consideration received on account of issuance of additional shares. In our considered view, Ld. CIT(Appeals) has not erred in facts and in law in computing the FMV of shares on the above lines. The ITAT in the case of **ACIT v. Y.**

VenkannaChoudaryheld[2019] 112 taxmann.com 71 (Visakhapatnam - Trib.), relying upon the coordinate bench of Tribunal in **Sadhvi Securities (P.) Ltd. v. Asstt. CIT [2019] 109 taxmann.com 245/179 ITD197 (Delhi - Trib.)** held that in case the balance sheet was not drawn up on the date of allotment, the previous balance sheet which was approved in the AGM has to be considered for valuation of FMV of the shares. Thus, ITAT held that for arriving the FMV of shares previous Balance sheet which is audited and approved in the AGM has to be taken into consideration, before the allotment of shares. In the present case, since the shares were allotted before Balance Sheet for AY 2013-14 was finalized, in our view Ld. CIT(Appeals) has not erred in computing the FMV per share considering the previous balance sheet which was approved in the AGM for valuation of FMV of the shares.

14. We shall now take up the individual Grounds raised by the respective parties.

We shall first deal with Department Grounds of Appeal.

Ground No. 1:

15. The Ground of the Department is dismissed. It is held that Ld. CIT(Appeals) has not erred in deleting addition in respect of proportionate allocation of shares relying on the decision of Sudhir Menon (*supra*).

16. Ground No. 1 of the Department's appeal is dismissed.

Ground No. 2:

17. In our view, Ld. CIT(Appeals) has not erred in adopting the valuation of shares at Rs. 205 per share considering the previous balance sheet which was approved in the AGM for valuation of FMV of the shares.

Ground No. 2 of the Department's appeal is dismissed.

18. Grounds No. 3, 4 and 5 of the Department Appeal are general and do not require any specific adjudication.

We shall now take up the assessee's Grounds of Appeal.

Ground No. 1

19. In our view, Ld. CIT(Appeals) has not erred in law and facts in upholding action of the Ld. Assessing Officer in initiating proceedings u/s issued notice u/s 148 of the Act. The detailed reasoning has been given in preceding paragraphs.

20. Ground No. 1 of the assessee's appeal is dismissed.

Ground No. 2:

21. In our view, Ld. CIT(Appeals) has erred in law and facts in upholding action of the Ld. Assessing Officer in confirming addition in respect of

82,200 shares allotted to renouncement of rights by wife and father in favour of the assessee u/s 56(2)(vii)(c) of the Act.

Ground No. 2 of the assessee's appeal is allowed.

Ground No. 3

22. In our view, Ld. CIT(Appeals) has not erred in law and facts in upholding action of the Ld. Assessing Officer in confirming addition in respect of disproportionate allotment of 14,800 shares, allotted to the assessee by renouncement of rights by third party shareholders in favour of the assessee, u/s 56(2)(vii)(c) of the Act.

23. Ground No. 3 of the assessee's appeal is dismissed.

Ground No. 4:

24. Ground No.4 is summation of Grounds 2 and 3 above and does not require any specific adjudication.

Grounds 5 to 7:

25. The Ld. Counsel for the assessee submitted that Ground No. 5 is not being pressed. Grounds 6 to 7 are general in nature and do not require any specific adjudication.

26. In the combined result, Department's appeal is dismissed and the assessee's appeal is partly allowed.

Order pronounced in the open court on 06-05-2022

Sd/-

(ANNAPURNA GUPTA)
ACCOUNTANT MEMBER
Ahmedabad : Dated 06/05/2022

Sd/-

(SIDDHARTHA NAUTIYAL)
JUDICIAL MEMBER

आदेश की प्रतिलिपि अग्रेषित / Copy of Order Forwarded to:-

1. Assessee
2. Revenue
3. Concerned CIT
4. CIT (A)
5. DR, ITAT, Ahmedabad
6. Guard file.

By order/आदेश से,

उप/सहायक पंजीकार
आयकर अपीलीय अधिकरण,
अहमदाबाद