

आयकर अपीलीय अधिकरण “डी” न्यायपीठ मुंबई में।
IN THE INCOME TAX APPELLATE TRIBUNAL
“D” BENCH, MUMBAI

माननीय श्री महावीर सिंह, उपाध्यक्ष एवं
माननीय श्री मनोज कुमार अग्रवाल, लेखा सदस्य के समक्ष।
BEFORE HON’BLE SHRI MAHAVIR SINGH, VP AND
HON’BLE SHRI MANOJ KUMAR AGGARWAL, AM

आयकर अपील सं./ I.T.A. No.5748/Mum/2017
(निर्धारण वर्ष / Assessment Year: 2014-15)

Income Tax Officer-13(1)(3) 2 nd Floor, Room No.225 Aaykar Bhavan, M.K. Road Mumbai-400 020	बनाम / Vs.	Shri Rajeev Ratanlal Tulshyan 4101, 4 th Floor, C-Wing Lodha Bellissimo, J.B. Boricha Marg Lower Parel, Mumbai-400 011
स्थायीलेखासं ./जीआइआरसं ./PAN/GIR No. ABOPT-2790-D		
(अपीलार्थी/ Appellant)	:	(प्रत्यर्थी / Respondent)

&

Cross Objection No.118/Mum/2018

(Arising out of I.T.A. No.5748/Mum/2017)
(निर्धारण वर्ष / Assessment Year: 2014-15)

Shri Rajeev Ratanlal Tulshyan 4101, 4 th Floor, C-Wing Lodha Bellissimo, J.B. Boricha Marg Lower Parel, Mumbai-400 011	बनाम/ Vs.	Income Tax Officer-13(1)(3) 2 nd Floor, Room No.225 Aaykar Bhavan, M.K. Road Mumbai-400 020.
स्थायीलेखासं ./जीआइआरसं ./PAN/GIR No. ABOPT-2790-D		
(अपीलार्थी/ Appellant)	:	(प्रत्यर्थी / Respondent)

Assessee by	:	Shri Rushabh Mehta- Ld.AR
Revenue by	:	Shri Gaurav Batham-Ld. CIT-DR

सुनवाई की तारीख/ Date of Hearing	:	22/07/2021
घोषणा की तारीख / Date of Pronouncement	:	01/10/2021

आदेश / O R D E R**Manoj Kumar Aggarwal (Accountant Member)**

1.1 Aforesaid appeal by revenue for Assessment Year (AY) 2014-15 arises out of the order of Ld. Commissioner of Income-Tax (Appeals)-21,

Mumbai, [in short referred to as 'CIT(A)'] dated 16/06/2017 in the matter of assessment framed by learned Assessing Officer (AO) u/s 143(3) on 30/12/2016. The revenue has filed revised grounds which read as under:

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1. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in restricting the addition of Rs.42,87,75,000/- to Rs.1,50,87,320/- under section 56(2)(vii)(c)(ii) of the Income-tax Act, without appreciating the fact that the addition was made as income from other sources totalling to Rs.42,87,75,000/-.

2. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in restricting the addition without appreciating the fact that the assessee has failed to discharge its onus of explaining the charging @ Rs.10.85 per share with proper explanations and supporting evidences.

1.2 The assessee has filed cross-objection on following grounds: -

1. (a) The Id. CIT(A) erred in facts and law in applying the provisions of section 56(2)(vii)(c)(ii) of the Act and confirming the addition to the extent of Rs.1,50,87,320/-.

(b) The Id. CIT(A) erred in facts and law in not appreciating that the appellant had applied for and was allotted shares in right issue only to the extent to which he was entitled to in proportion of his existing-shareholding and therefore section 56(2)(vii)(c)(ii) ought not have been invoked.

(c) The Id. CIT(A) erred facts and law in not appreciating that the appellant had been in fact "allotted" the right shares on creation which cannot be equated to as "received" as envisaged u/s. 56(2)(vii)(c)(ii) of the Act.

(2) Without prejudice and without accepting the applicability of the provisions of section 56(2)(vii)(c)(ii) of the Act, the Id. CIT(A) erred in facts and law in not appreciating that the rise in shareholding of the appellant is substantially due to inaction on part of his relatives to exercise the right issue of shares offered to them and that the addition made to that extent ought to have been excluded from the rigors of section 56(2)(vii)(c)(ii) of the Act.

As evident, the sole subject matter of dispute is addition as made by Ld. AO u/s 56(2)(vii)(c)(ii). The assessee being resident individual is stated to be director and a major shareholder in an entity namely M/s Kennington Fabrics Private Limited (KFPL).

1.3 The Ld. AR as well as Ld. CIT-DR advanced arguments along with written submissions. Reliance has been placed on various case laws. The Ld. AR has submitted that the case is squarely covered in assessee's favor by the decision of this Tribunal in **Sudhir Menon HUF**

V/s ACIT (45 taxmann.com 176) and various other decisions. The copies of the same have been placed on record. The Ld. CIT-DR, on the other hand, controverted the arguments put forth by Ld. AR.

1.4 We have carefully heard the rival submissions and perused relevant material on record. The judicial pronouncements as cited during the course of hearing have duly been deliberated upon. Our adjudication to the subject matter of appeal would be as given in succeeding paragraphs.

Assessment Proceedings

2.1 The dispute stems from the fact that the assessee was a director and a major shareholder in an entity namely M/s Kennington Fabrics Private Limited (KFPL). During the year, KFPL offered right issue and the assessee was allotted 3.95 Crores shares of KFPL at face value of Re.1/- each in the right issue. However, it was alleged by Ld. AO that the consideration of Re.1/- per share was less than fair market value (FMV) of shares as calculated in accordance with the provisions of Sec.56(2)(vii)(c)(ii) read with rule 11U & 11UA and therefore, the difference between FMV and the consideration paid by the assessee would be taxable in the hands of the assessee u/s 56(2)(vii).

2.2 The assessee, inter-alia, relied on the decision of Mumbai Tribunal in **Sudhir Menon HUF** (supra) wherein it was held that in case of proportionate allotment of shares, there would be no taxability u/s 56(2)(vii)(c)(ii). However, in case of disproportionate allotment of shares, these provisions may get attracted.

2.3 However, Ld. AO noticing that the percentage of share holding of the assessee in KFPL increased from 90.37% as on 31/03/2013 to 96.88% as on 31/03/2014, opined that there was disproportionate

allotment of shares and therefore, the stated provisions would apply in assessee's case.

2.4 Accordingly, Ld. AO worked out intrinsic value per share as on 31/03/2013 at Rs.11.85 per share on the basis of formula laid down in Rule 11U and 11UA which was as follows: -

$$\frac{(A-L) \times (PV)}{(PE)}$$

(PE)

Where A would represent book value of the assets in the balance-sheet, L would represent book value of liabilities shown in the balance-sheet, PE would be total amount of paid up equity share capital as shown in the balance-sheet and PV would be paid-up value of such equity shares.

2.5 Finally, the differential amount of Rs.10.85 per share (Rs.11.85 per share less issue price of Re.1/- per share) was added to the income of the assessee which resulted into an addition of Rs.4285.75 Lacs in the hands of the assessee.

Appellate Proceedings

3.1 During appellate proceedings, the assessee assailed the impugned additions by way of elaborate written submissions which have already been extracted in the impugned order. It was submitted that the shares were offered on right basis by KFPL on proportionate basis to all existing shareholders. The assessee subscribed to the right issue only to the extent of proportionate offer and no further. The attention was drawn to CBDT Circular No. 5 of 2010 dated 03/06/2010 which provided that the newly introduced provisions of Sec. 56(2)(vii) were anti-abuse measures. Similarly, CBDT Circular No.1 of 2011 provided that these provisions were introduced as a counter evasion mechanism to prevent laundering of unaccounted income. The provisions were intended to extend the tax

net to such transactions in kind. The intent was not to tax the transactions entered into the normal course of business and trade, the profits of which are taxable under specific head of income.

3.2 On the strength of these arguments, the assessee submitted that initially it was holding 87.50 Lacs shares which constitute 90.37% shares of KFPL. During the year, vide board resolution dated 09/08/2013, the shareholders holding 7 shares were offered 8 shares at a price of Re.1/- per share. Vide another board resolution dated 06/03/2014, the shareholders holding 5 shares were offered 8 shares at price of Re.1/- per share. Accordingly, vide Board Resolution dated 09/08/2013, the assessee along with other shareholders was offered following shares: -

Name of Shareholder	Existing Holding	Proposed Offer
Rajeev R. Tulshyan	87,50,000	1,00,00,000
Lalitadevi Tulshyan	2,50,000	2,85,714
Adila Ltd.	6,76,746	7,73,424
Total	96,76,746	1,10,59,138

In the second right-issue, vide Board Resolution dated 06/03/2014, the assessee along with other shareholders was offered following shares: -

Name of Shareholder	Existing Holding	Proposed Offer
Rajeev R. Tulshyan	1,87,50,000	3,00,00,000
Lalitadevi Tulshyan	2,50,000	4,00,000
Adila Ltd.	6,76,746	10,82,793
Aljabriah Metals Trading LLC	3,25,656	5,21,050
Pooja Tulshyan	3,00,000	4,80,000
Total	2,03,02,402	3,24,83,843

The assessee subscribed 1 Crores shares in the first right offer whereas it subscribed 2.95 Crores shares in the second right offer. Accordingly, the share holding pattern at the beginning of the year vis-à-vis at the end of the year was as follows:-

Name of Shareholder	No. of equity shares held as on 31.03.2013	% Holding as on 31.03.2013	No. of equity shares held as on 31.03.2014	% Holding as on 31.03.2014
Rajeev R. Tulshyan	87,50,000	90.37%	4,82,50,000	96.88%
Adila Ltd.	6,76,746	6.99%	6,76,746	3.38%
Other shareholders	2,55,000	2.63%	8,75,656	1.70%
Total	96,76,746	100%	4,98,02,402	100%

3.3 On the basis of above tabulation, it was demonstrated that the assessee was offered shares only as per his proportionate entitlement and nothing more and therefore, in terms of the cited decision, the provisions of Sec.56(2)(vii) were not attracted. It was further argued that it was not a case of tax evasion or money laundering but a pure genuine commercial arrangement in the normal course of business. The intention of the provisions was to check evasion of tax and the provisions were introduced as anti-abuse provisions. The amendment was introduced to overcome the money laundering activities undertaken on abolition of Gift Tax Act; Since the Gift tax Act was not applicable to issue of shares, the provisions of Sec.56(2) would not apply to transaction of such nature as per the decision of Bangalore Tribunal in **DCIT V/s Dr. Rajan Pal (ITA No.1290/Bang/2015)**. Another argument was that that the provisions of Sec.56(2)(vii) would be applicable to recipient of the property or money. Such property includes shares and securities being capital assets of the assessee. However, in the present case, the shares come into existence only on allotment. The term allotment would mean the appropriation out of previously un-

appropriated share capital of a company of a certain number of shares to a person. Till such allotment, the shares do not exist as such. It is only on allotment that the shares come into existence. As held by Hon'ble Supreme Court in **Khoday Distilleries Ltd. (CA No.6654 of 2008)**, allotment of shares is a creation of shares and not a transfer of shares, There is vital difference between the two. An allotment is the creation of shares by appropriation out of the unappropriated share capital to a particular person. A share is a chose in action. A chose in action implies existence of some person entitled to the rights in action in contradistinction to a subscriber and the purchase of shares from an existing shareholder. The first case is that of creation whereas the second case is that of transfer. An allotment is not a transfer and does not attract Section 4(1)(a) of the Gift Tax Act. It was, therefore, contended that the property must be in existence at the time when it was received from a person. In the present case the shares come into existence only after the shares have been allotted and therefore, the provisions of Sec.56(2)(vii) could not be made applicable. However, at the same time, it was admitted by the assessee that similar argument was rejected by Mumbai Tribunal in **Sudhir Menon HUF (supra)** wherein the bench held that though allotment of shares is not to be regarded as transfer but since the assessee is receiving property in the form of shares, the provisions of Sec.56(2)(vii) would apply.

3.4 It was further submitted by the assessee that the shares were offered to all the existing shareholders at the same price and in the same proportion in which they were entitled to. Each shareholder had the

same right of entitlement to right issue. Thus, what the assessee had received, it was within his entitlement of rights and he has not received anything more over and above thereof. Accordingly, the provisions would have no application since no special benefit was offered to the assessee. The same was sought to be supported by the fact that in a right issue / proportionate allotment, apart from issue price, there is also an inherent consideration in the form of diminution in the value of the existing shares held by the assessee.

3.5 In the alternative, the assessee submitted that the addition was to be restricted only to disproportionate allotment of shares to assessee and after factoring in the value of the existing shares which would be 150.87 Lacs as tabulated on page nos. 24 and 25 of the appellate order.

3.6 Finally, the assessee summed up the arguments as follows: -

- (i) The provisions of section 56(2)(vii)(c) of the Act should not be made applicable to a genuine transaction of issue of shares having regard to the purpose of introduction of the said section.
- (ii) The section applies only where the property (in existence) is received by the appellant and not at the time where the property comes into existence.
- (iii) The appellant cannot be fastened with liability of taxation based on action or inaction of a third person when a proportionate / equitable offer was proposed to each shareholder and shares were allotted as per their proportionate eligibility only.
- (iv) Without prejudice, the addition if any has to be computed proportionately based on the rationale of the Hon'ble Mumbai ITAT in the case of Sudhir Menon HUF (supra) and Hon'ble Bangalore ITAT in case of DCIT v. Dr. Rajan Pai (supra).
- (v) Without prejudice, addition should be restricted to real benefit availed; if any after reducing the same in relation to proportionate share relatable to the relatives of the appellant.

3.7 The Ld. CIT(A), after due consideration of factual matrix as well as assessee's submissions, noted that KFPL issued additional fresh shares on rights / proportionate basis on two occasions during the year.

As per the decision of Mumbai Tribunal in Sudhir Menon HUF (supra), the argument that the shares do not exist before allotment and therefore, the provision of Sec. 56(2) would not apply, was to be rejected. However, it was noted that in case of issue of bonus shares, no property is being conveyed as the property therein is comprised in the existing shareholding of the allottee. It was held that the section would however apply to allotment of shares on rights basis but will depend on the terms of allotment. If the shares are allotted strictly on proportionate basis based on existing shareholding, then though the provisions per-se is 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. Since Ld. AO noted that the allotment was disproportionate, the provisions of Sec.56(2)(vii)(c) will apply. However, the principle of diminution in value of existing shareholding has to be considered while determining the gain. Therefore, the addition of Rs.150.87 Lacs, as alternatively worked out by the assessee, was to be accepted. No further adjustment on account of deemed gift by family members of the assessee was to be granted since the family members have not been allotted shares which were thereafter transferred to the assessee. Secondly, there was no evidence of any conscious act of gifting to the assessee. In other words, the impugned addition was restricted to the extent of 150.87 Lacs. Aggrieved, the revenue is in further appeal before us whereas the assessee, upon receipt of notice of hearing, has filed cross-objection against the same.

Our findings and adjudication

4. Upon perusal of factual matrix, orders of lower authorities and the submissions made by the assessee during appellate proceedings as well

as before us, we find that there is clear fallacy in the conclusion of lower authorities that the allotment was dis-proportionate and skewed in favor of the assessee in view of the fact that assessee's shareholding increased from 90.37% to 96.88% at year end. The said conclusion has overlooked the fact that there were two right offers during the year and the right issue was offered, on both occasions, to existing shareholders in the ratio of 7:8 on first occasion and 5:8 on the second occasion. The issue was offered to existing shareholders in proportion to their holding at the same price i.e. Re.1/- per share. The same is supported by Board Resolution dated 09/08/2013 and 06/03/2014 and this fact is nowhere in dispute. The assessee subscribed his entitlement but the other shareholders did not subscribe to the entitlements. Resultantly, the assessee's overall holding increased at year-end and the holding ratio got skewed in assessee's favor. The said conclusion is duly evidenced from assessee's tabulation during appellate proceedings as extracted by us in preceding para 3.2 of the order. This being so, the ratio of decision of Mumbai Tribunal in **Sudhir Menon HUF V/s ACIT (45 taxmann.com 176)** would be applicable to the facts of the case wherein, on similar factual matrix, the coordinate bench held that as long as there was no disproportionate allotment i.e. shares are allotted pro-rata to the shareholders, based on their existing holdings, there is no scope for any property being received by them on the said allotment of shares; there being only an apportionment of the value of their existing holding over a larger number of shares. In such a case, the provisions of Sec.56(2)(vii)(c) would not get attracted. A higher than proportionate or a non-uniform allotment though would, and on the same premise, attract the rigor of the provision. This is only understandable inasmuch as the

same would only be to the extent of the disproportionate allotment and, further, by suitably factoring in the decline in the value of the existing holding.

4.2 Applying the ratio of above decision, coordinate bench of Mumbai Tribunal in **ACIT V/s Subodh Menon (103 Taxmann.com 15)**, observed that the provisions of Section 56(2)(vii) does not apply to bona-fide business transaction. The CBDT Circular No.1/2011 dated 06/04/2011 explaining the provision of section 56(2)(vii) specifically states that the section was inserted as a counter evasion mechanism to prevent money laundering of unaccounted income. In paragraph 13.4 thereof, it is stated that "the intention was not to tax transactions carried out in the normal course of business or trade, the profit of which are taxable under the specific head of income". Therefore, the aforesaid transactions, as carried out in normal course of business, would not attract the rigors of provisions of Sec.56(2)(vii).

4.3 We also concur with the submissions of Ld. AR that the provision of Section 56(2)(vii) were anti-abuse provision inserted post abolition of Gift Tax Act. The same is evident from CBDT Circular No. 05/2010 dated 03/06/2010 which provided that Section 56 is being introduced as an anti-abuse measure. The same is fortified in CBDT Circular No. 01/2011 dated 06/04/2011 which also provided that these provisions are anti-abuse provisions which were applicable only if an individual or an HUF is the recipient. Therefore, transfer of shares of a company to a firm or a company, instead of an individual or an HUF, without consideration or at a price lower than the fair market value does not attract the anti-abuse provision. Further, the provisions of section 56(2)(vii) were introduced as a counter evasion mechanism to prevent laundering of unaccounted

income. The provisions were intended to extend the tax net to such transactions in kind. The intent is not to tax the transactions entered into in the normal course of business or trade, the profits of which are taxable under specific head of income...." On the basis of the same, it could be inferred that provisions of section 56(2)(vii) were introduced as an anti-abuse measure and to prevent laundering of unaccounted income under the garb of gifts, after abolition of the Gift Tax Act. Upon perusal of orders of lower authorities, we find that there are no such allegations and no case of tax evasion or tax abuse has been made out against the assessee. In fact, the transactions are ordinary transactions of issue of right shares to existing shareholders in proportion to their existing shareholding and therefore, no case of abuse or tax evasion could be made out against the assessee.

4.4 This proposition is supported by the fact that in line with the intent of legislatures, CBDT issued another Circular No. 10/2018 on 31/12/2018 clarifying that keeping in view the legislative intent to apply anti-abuse measures, Section 56(2)(vii) of the Act shall not be applicable in case of receipt of shares as a result of fresh issuance of shares, including by way of issue of bonus shares, rights shares and preference shares. However, the said circular was withdrawn immediately vide another Circular No.02/2019 dated 04/01/2019 and new Circular No. 03/2019 dated 21/01/2019 was issued wherein it was mentioned that the view taken in Circular No.10/2018 (subsequently withdrawn by Circular No.02/2019) that section 56(2)(vii) of the Act would not apply to fresh issuance of shares, would not be a correct approach, as it could be subject to abuse and would be contrary to the express provisions and the legislative intent of section 56(2)(vii) or

similar provisions contained in section 56(2) of the Act. Nevertheless, the fact that intent of introducing the provisions was anti-abusive measures still remain intact and there is no reason to depart from the understanding that the provisions were counter evasion mechanism to prevent laundering of unaccounted income. Therefore, the same do not apply to genuine issue of shares to existing shareholders. This position is duly supported by the decision of Bangalore Tribunal in **DCIT V/s Dr. Ranjan Pai (ITA No. 1290/Bang/2015)** which is further affirmed by the Hon'ble Karnataka High Court in ITA No. 501 of 2016 dated 15/12/2020.

4.5 Therefore, on the given facts and circumstances, the impugned additions as made by Ld. AO in the assessment order are not sustainable in the eyes of law. By deleting the same, we allow Ground Nos. 1(a) & 1(b) of assessee's cross-objections which render other grounds of cross-objections as infructuous. The revenue's appeal stand dismissed.

Conclusion

5. The revenue's appeal stand dismissed whereas the assessee's cross-objections stand partly allowed.

Order pronounced on 1st October, 2021.

Sd/-

(Mahavir Singh)

उपाध्यक्ष / Vice President

Sd/-

(Manoj Kumar Aggarwal)

लेखा सदस्य / Accountant Member

मुंबई Mumbai; दिनांक Dated :01/10/2021
Sr.PS, Dhananjay

आदेशकीप्रतिलिपिअग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी/ The Appellant
2. प्रत्यर्थी/ The Respondent
3. आयकरआयुक्त(अपील) / The CIT(A)
4. आयकरआयुक्त/ CIT– concerned
5. विभागीयप्रतिनिधि, आयकरअपीलीयअधिकरण, मुंबई/ DR, ITAT, Mumbai
6. गार्डफाईल / Guard File

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