

आयकर अपीलिय अधिकरण, 'बी' न्यायपीठ, चेन्नई IN THE INCOME TAX APPELLATE TRIBUNAL 'B' BENCH: CHENNAI		
श्री वी. दुर्गा राव, माननीय न्यायिक सदस्य एवं श्री मंजूनाथा.जी, माननीय लेखा सदस्य के समक्ष BEFORE SHRI V. DURGA RAO, HON'BLE JUDICIAL MEMBER AND SHRI MANJUNATHA. G, HON'BLE ACCOUNTANT MEMBER		
आयकर अपील सं./ITA No.623/Chny/2022 निर्धारण वर्ष/Assessment Year: 2017-18		
M/s.Mercantile Ventures Ltd., No.88, SPIC House, Mount Road, Guindy, Chennai-600 032. [PAN: AAICM 6095 N] (अपीलार्थी/Appellant)	v.	The Asst. Commissioner of- Income Tax, Corporate Circle-4(1), Chennai. (प्रत्यर्थी/Respondent)
अपीलार्थी की ओर से/ Appellant by	:	Shri P.V.Sudhakar, Advocate
प्रत्यर्थी की ओर से /Respondent by	:	Shri V. Nandakumar, CIT
सुनवाईकीतारीख/Date of Hearing	:	02.01.2024
घोषणाकीतारीख /Date of Pronouncement	:	14.02.2024

आदेश / ORDER

PER MANJUNATHA.G, AM:

This appeal filed by the assessee is directed against the order of the Principal Commissioner of Income Tax, Chennai, dated 31.03.2022, and pertains to assessment year 2017-18.

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

A. The order passed by the PCIT under Sec.263 of the I.T. Act revising the well considered order of the Assessing Officer is wrong, contrary to law and opposed to the facts and circumstances of the case.

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B. The PCIT is-wrong in issuing the notice on one ground and passing the order on a different ground which amounts to a violation of the principles of natural justice. The notice issued under Sec.263 of the I.T. Act was on the ground that the fair market price as on the date of allotment of shares to the appellant ranged from Rs. Nil to Rs.5.92 per share and not Rs.10 as quoted by the appellant and that the cost price of shares has been escalated by the appellant to derive short term capital loss. In response to the notice, the appellant had filed its reply relying upon Sec.53 of the Companies Act which prohibits issue of equity shares at a discount. However the PCIT without considering the reply filed has proceeded to pass the order finding fault with the fair market value arrived as per Rule 11UA(1)(c) of the IT. Rules during transfer/sale of the said shares which was not spelt out in the show cause notice.

C. The PCIT ought to have seen that the provisions of Sec.53(1) of the Companies Act prohibits issue of shares at a discount and as per Sec.53(2) any share issued at a discounted price is void. The PCIT ought to have further seen that under Sec.53(3), any contravention of Sec.53 (1) is also an offence punishable with fine in the hands of the issuing company and every officer of the issuing company are liable for imprisonment or fine or both. Therefore the PCIT ought to have taken note of the mandatory statutory provisions of the Companies Act and dropped the proposal for revision.

*D. To justify the revision, the PCIT has concluded that the amounts due by the eight companies were in default for more than a decade and the eight companies right from the inception are not credit worthy and that no company (appellant) with sensible persons would accept shares with a negative value in lieu of loans advanced. However the PCIT has here again failed to appreciate that issue of shares at a discount is not permitted under the Companies*Act and further by virtue of accepting the shares allotted by the defaulting companies in lieu of the loans advanced and in turn transferring the same to another entity, the appellant had in fact recovered more than 20% of the loans advanced which would have otherwise been written off as bad debts. In other words the appellant has offered to tax 20% of the loan recovered instead of writing off the entire 100% as bad debts. Therefore the transaction is bonafide and permissible and the appellant is entitled to the claim the resultant short term capital loss.*

E. The PCIT is also wrong in finding fault with the computation of the fa:-market value as per Rule 11UA(1)(c) of the IT. Rules at the time of sale of the unquoted shares to M/s South India Travels Pvt. Ltd. However the PCIT has failed to note and appreciate that in the show cause notice it was the specific assertion that the fair market price as on the date of purchase of shares by the appellant ranged from Rs.nil to Rs.5.92 per share. Compared to the fair market value arrived at by the appellant at the time of transfer/sale which was between Rs.0.50 to Rs.6 per share, there is no big difference.

F. The PCIT is also wrong in holding that the process of valuation was not undertaken when the shares were allotted by the eight companies to the appellant but were undertaken only at the time of transfer of the shares. In holding so, the PCIT has failed to note and appreciate that the provisions of the IT. Act provide for valuation of shares only when the shares are transferred and not during the initial allotment.

G. The PCIT has failed to note and appreciate that as per Rule 11UA(C)(c)of the I. T. Rules, the fair market value of unquoted shares of a company shall be estimated to be the price it would fetch if sold in the open market on the date of valuation. In the instant case the shares transferred by the appellant are unquoted shares and the fair market price of such shares has been arrived at and certified by a qualified Chartered Accountant. The valuation having been done in accordance with Rule 11 UA(C)(c) of the I. T. Rules ought not to have been found fault with. In any event even as per the show notice issued by the PCIT the fair market price on the date of purchase/acquisition of shares by the appellant ranged between Rs. Nil to Rs.5.92 per share and the fair market price valued (estimated) by the appellant at the time of transfer/sale of the said shares ^ranged between Rs.0.50 to Rs.6 per share which are almost in the same range.

H. The PCIT is -wrong in treating the transaction of allotment of shares by the eight companies to the appellant as between related enterprises even while rendering a specific

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finding that the shareholding pattern of the appellant company may not connect with that of the eight companies as related enterprise.

I. Therefore viewed from any angle the order passed by the PCIT is unsustainable in law and requires to be set aside.

J. The appellant reserves its right to raise additional grounds at the time of hearing of the appeal.

3. At the outset, we find that appeal filed by assessee is barred by limitation for which necessary petition for condonation of delay explaining the reasons for the delay has been filed. The learned counsel submitted that assessee could not file appeal within the time allowed under the Act, therefore delay may be condoned. Having heard both sides and considered the petition filed by the assessee for condonation of delay, we are of the considered view that reasons given by assessee for not filing the appeal within the time allowed under the Act comes under reasonable cause as provided under the Act for condonation of delay and hence, delay in filing of above appeal is condoned and appeal filed by the assessee is admitted for adjudication.

4. The brief facts of the case are that the assessee is engaged in the business of leasing of immovable properties, investments and man power supply services. The assessee formerly known as M/s.MCC Finance Ltd., had provided unsecured loans to eight investment companies prior to 1999. M/s.MCC Finance Ltd., went into liquidation and was under the control of the official liquidator during the period August, 2000 to October, 2012. The said company was revived during December, 2012 under a

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'Scheme of Amalgamation' approved by the Hon'ble Madras High Court and thereafter, the name of M/s.MCC Finance Ltd., was changed to the present assessee, M/s.Mercantile Ventures Ltd. The said eight companies to whom the assessee provided unsecured loans were under severe financial crisis, had settled their outstanding loans to the assessee amounting to Rs.39.21 Crs. by issue of equity shares of Rs.10/- per share during January/February, 2017. The assessee sold unquoted equity shares of eight investment companies during Marcy, 2017 to M/s.South India Travels Pvt. Ltd., on the basis of share valuation done under Rule 11UA of the Income Tax Rules, 1962, and the fair value of the shares sold in eight investment companies were in the range of Rs.0.50 to Rs.6/- per share. The sale proceeds amounting to Rs.822.03 lakhs was received through banking channel. The assessee has computed 'short term capital loss' of Rs.3098.48 lakhs from transfer of unquoted equity shares of eight investment companies.

5. The assessee has filed return of income for AY 2017-18 on 22.08.2017 admitting total income of Rs.3,74,45,170/- and had simultaneously claimed 'short term capital loss' of Rs.30,34,45,783/- which has been carried forward to subsequent year. The case was selected for scrutiny and the assessment has been completed u/s.143(3) of the Act on 21.12.2019 and accepted the income declared by the assessee.

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6. The case has been, subsequently, taken up for revision proceedings and accordingly, show cause notice u/s.263 of the Act, dated 01.12.2022 was served on the assessee. In the said show cause notice, the PCIT was of the opinion that the assessment order passed by the AO is erroneous in so far as it is prejudicial to the interest of the Revenue, because, the AO has failed to verify the issue of 'short term capital loss' declared by the assessee from sale of unquoted equity shares pertaining to eight investment companies in right perspective of law, even though, the assessee has escalated the price of the shares to derive artificial 'short term capital loss'. Since, the AO has completed assessment without carrying out required enquiries he ought to have been carried out in light of provisions of the Act, which resulted in excessive loss/allowance allowed to the assessee. Therefore, the PCIT opined that the assessment order passed by the AO is erroneous in so far as prejudicial to the interest of the Revenue, and thus, called upon the assessee to explain 'as to why' the assessment order passed by the AO dated 21.12.2019, shall not be revised in terms of provisions of Sec.263 of the Act. In response, the assessee vide letter dated 21.02.2022 submitted that the assessment order passed by the AO is neither erroneous nor prejudicial to the interest of the Revenue, because, the assessee has rightly computed 'short term capital loss' derived from sale of equity shares of unlisted companies, even though, as per Valuation Report carried out under Rule 11UA of the Income Tax Rules, 1962, fair value of the shares sold during the range of

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Rs.0.50 to Rs.6/- per share because of certain restrictions under the Companies Act, 2013, more particularly, u/s.53(1) & (2) of the Companies Act, 2013, the assessee cannot issue shares at discount except as provided in Sec.54 of the Act. Since, the companies could not issue shares at discount, it has got allotment of shares at face value for recovery of outstanding loans from those companies, and thus, genuine capital loss declared by the assessee cannot be treated as structured transactions to derive undue benefit. The AO after considering relevant facts has rightly allowed the claim of the assessee, and thus, it cannot be said that the assessment order passed by the AO is erroneous in so far as it is prejudicial to the interest of the Revenue.

7. The PCIT after considering relevant submissions of the assessee and also taken note of various facts, including the financial position of eight investment companies opined that the assessment order passed by the AO is erroneous in so far as it is prejudicial to the interest of the Revenue, because, the AO has completed the assessment and accepted 'short term capital loss' declared by the assessee from transfer of unquoted equity shares, even though, the assessee has escalated share price when the shares were issued to said companies and subsequently, sold said shares in the next month as per Valuation Report carried under Rule 11UA of the Income Tax Rules, 1962 and as per said report, Fair Market Value of the shares were ranging from Rs.0.50 to Rs.6/- per share. Although, **prima**

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facie it appears that the assessee has structured the transaction in collusion with group entities to derive undue benefit of 'short term capital loss', but the AO has failed to examine the issue in light of relevant details filed by the assessee to ascertain the correct nature of transactions, which rendered the assessment order passed by the AO is erroneous in so far as it is prejudicial to the interest of the Revenue. Thus, rejected arguments of the assessee and set aside the assessment order passed by the AO u/s.143(3) of the Act, dated 21.12.2019 and direct the AO to disallow the claim of 'short term capital loss' claimed by the assessee. The AO is also simultaneously directed to invoke the rectification proceedings u/s. 154 of the Act, and exclude appropriate portion of 'short term capital loss' undoubtedly created in AY 2017-18 and adjusted against the Capital Gains earned in the succeeding years. Aggrieved by the order of the Ld.CIT(A), the assessee is in appeal before us.

8. The Ld.Counsel for the assessee, Shri P.V.Sudhakar, Advocate, submitted that the PCIT is erred in setting aside the assessment order passed by the AO u/s.143(3) of the Act, dated 21.12.2019 by exercising his powers conferred u/s.263 of the Act, even though, the assessment order passed by the AO is neither erroneous nor prejudicial to the interest of the Revenue.

9. The Ld.Counsel for the assessee, further referring to the order of the PCIT dated 31.03.2022 submitted that no doubt, the Fair Market

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Value of shares of unquoted equity shares of eight investment companies, when the shares were sold is ranging from Rs.0.50 to Rs.6/- per share and such value has been arrived at in terms of Rule 11UA of the Income Tax Rules, 1962. But, fact remains that the assessee has explained the reasons for not issuing shares at discount, because of restriction imposed u/s.53(1) & (2) of the Companies Act, 2013. The assessee had also explained reasons for subscription of shares of eight investment companies at face value and according to the assessee, the loans advanced to eight investment companies were overdue and those companies were unable to repay the loans, because of their financial distress. Therefore, the assessee decided to convert the loans into equity shares and accordingly, took allotment of shares in eight companies on face value. Since, the companies were not doing well, the assessee decided to liquidate the investment in shares and accordingly, sold the shares on Fair Market Value to another company and received consideration through proper banking channel which resulted in 'short term capital loss'. Therefore, the PCIT is erred in coming to the conclusion that the assessee has artificially created 'short term capital loss' and carried forward to subsequent years, is incorrect and devoid of merits. Although, these facts have been explained to the PCIT, but the PCIT rejected the explanation of the assessee and held that the assessment order passed by the AO is erroneous in so far as it is prejudicial to the

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interest of the Revenue. Therefore, he submitted that the order of the PCIT should be set aside.

10. The Ld.CIT-DR, Shri Nandakumar, supporting the order of the PCIT, submitted that it is an admitted fact that the assessment order is totally silent about any kind of discussion on the issue of 'short term capital loss' declared by the assessee from sale of unquoted equity shares of eight companies. Further, the PCIT has brought out clear facts to the effect that the assessee has escalated share price when the shares were subscribed and also sold the shares within one month and claimed that said sale was as per Fair Market Value of the shares. He further submitted that as per facts brought on record by the PCIT, the assessee has got allotment of equity shares at face value of Rs.10/- per share and within one month, sold said shares at the rate of Rs.0.50 to Rs.6/- per share. Further, the assessee is not disputing the Fair Market Value of the shares when the shares were sold. Therefore, from the above, it is undisputedly clear that when the shares got allotted to the assessee, the prices were escalated and within one month, said shares were sold at Fair Market Value which resulted in artificial 'short term capital loss'. Although, the assessee has structured the transactions in collusion with related companies and created artificial 'short term capital loss', but the AO failed to carry out required enquiries he ought to have been carried

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out. Thus, invocation of jurisdiction by the PCIT u/s.263 of the Act, is in accordance with law and the order of the PCIT should be upheld.

11. We have heard both the parties, perused the materials available on record and gone through orders of the authorities below. We have also carefully considered the reasons given by the PCIT to set aside the assessment order passed by the AO by exercising his powers conferred u/s.263 of the Act in light of various averments made by the Ld.Counsel for the assessee. We find that the assessment order passed by the AO u/s.143(3) dated 21.12.2019, is totally silent on the issue of 'short term capital loss' declared by the assessee from transfer of unquoted equity shares of eight investment companies. Although, the assessee has claimed 'short term capital loss' from sale of unquoted equity shares of eight investment companies and claimed partial set off of said loss, but the AO has not applied his mind to relevant facts in right perspective of law which is evident from the assessment order passed by the AO, where, the AO has not carried out required enquiries he ought to have been carried out in respect of 'short term capital loss' declared by the assessee. To this extent, it can be safely concluded that the assessment order passed by the AO is erroneous.

12. Having said so, let us come back whether assessment order passed by the AO is prejudicial to the interest of the Revenue. The order passed by the AO can be prejudicial to the interest of the Revenue, in case, the

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AO allowed excessive expenditure/allowance or loss, even though, said expenditure/allowance/loss is not allowable as per law. In the present case, as per facts brought on record by the PCIT in their order passed u/s.263 of the Act, it is abundantly clear that 'short term capital loss' declared by the assessee from transfer of unquoted equity shares of eight investment companies, is not occurred in the normal course of transactions. Further, as per details available on record, it is an admitted fact that the assessee has purchased/got allotment of unquoted equity shares of eight investment companies in the month of January/February, 2017 and said allotment was carried out at face value of Rs.10/- per equity share. The assessee has explained reasons for subscription of shares of eight companies and as per the assessee, it has advanced unsecured loans to eight companies way back in the year 1999 and said unsecured loans were overdue, because of severe financial crisis of investment companies. Further, the assessee company went into liquidation proceedings and was under the control of the Official Liquidator from August, 2000 to October, 2012. The assessee company was revived during December, 2012 and even after reviving, the assessee could not recover loans given to eight companies. Since, the investment companies were unable to repay the loan, the assessee decided to convert loans into equity and accordingly, got allotment of equity shares of eight companies. Further, although, Fair Market Value of equity shares of said companies is less than the face value, but, because there is a restriction under

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u/s.53(1) & (2) of the Companies Act, 2013 for allotment of shares at discount except as provided u/s.54 of the said Act, the assessee has taken allotment of equity shares at face value in order to recover the unpaid/unsecured loans from said companies. Since, the Fair Market Value of unquoted equity shares of eight investment companies were not worth keeping, the assessee has sold said shares in the month of March, 2017 to another company ranging from Rs.0.50 to Rs.6/- per share and received consideration of Rs.822.03 lakhs through proper banking channel. The said transactions had resulted in 'short term capital loss' of Rs.3098.48 lakhs.

13. We have given our thoughtful consideration to the reasons given by the Ld.Counsel for the assessee in light of relevant reasons given by the PCIT in their order dated 31.03.2022 and we do not find any merit in the arguments of the Ld.Counsel for the assessee for the simple reason that the facts brought on record by the PCIT clearly indicates collusion of parties to arrange structured transactions so as to derive undue benefit of 'short term capital loss'. Further, as admitted by the Ld.Counsel for the assessee itself, the Fair Market Value of unquoted equity shares of eight investment companies were not on par with face value of Rs.10/- per share when the shares were allotted in the month of January/February, 2017. Therefore, when Fair Market Value of the shares when allotted was not on par with face value of shares, in our considered view, no prudent businessman will venture into subscribe to said shares. Further, the

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analysis financial statements of eight companies as explained by the PCIT clearly reveals that the valuation has been done to arrive at Fair Market Value of shares, is not in accordance with Rule 11UA of the Income Tax Rules, 1962. Although, the assessee claims that it has agreed to subscribe to shares of eight companies at face value to recover unpaid/unsecured loans from said companies, but said claim was unsubstantiated. From the above and also from the reasons given by the PCIT in their order u/s.263 of the Act dated 31.03.2022, it is abundantly clear that although, the assessee and eight investment companies are not directly related by virtue of shareholding, but because of control and management, they can be considered as related parties. Since, the transactions between the assessee and eight companies were not 'at arm's length price' the resultant loss declared by the assessee from transfer of equity shares can at best be treated as structured transactions to derive undue benefit of 'short term capital loss'. Although, the assessee has claimed excessive loss from sale of equity shares of eight companies and allowed to carry forward to subsequent years, the AO has failed to carry out required enquiries he ought to have been carried out in light of Explanation-2 to Sec.263 of the Act, and thus, in our considered view, the assessment order passed by the AO u/s.143(3) of the Act dated 21.12.2019 definitely becomes prejudicial to the interest of the Revenue. Therefore, we are of the considered view that there is no error in the findings recorded by the PCIT to set aside the assessment order passed

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by the AO as erroneous in so far as it is prejudicial to the interest of the Revenue and thus, we are inclined to uphold the findings of the PCIT and dismiss the appeal filed by the assessee.

14. In the result, appeal filed by the assessee is dismissed.

Order pronounced on the 14th day of February, 2024, in Chennai.

Sd/-
(वी. दुर्गा राव)
(V. DURGA RAO)

न्यायिक सदस्य/**JUDICIAL MEMBER**
चेन्नई/Chennai,
दिनांक/Dated: 14th February, 2024.
TLN

Sd/-
(मंजूनाथा.जी)
(MANJUNATHA.G)

लेखा सदस्य/**ACCOUNTANT MEMBER**

आदेशकीप्रतिलिपिअग्रेषित/**Copy to:**

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|--------------------------|------------------------|-----------------|
| 1. अपीलार्थी/Appellant | 3. आयकरआयुक्त/CIT | 5. गार्डफाईल/GF |
| 2. प्रत्यर्थी/Respondent | 4. विभागीयप्रतिनिधि/DR | |