

## No tax on share premium when issued to Venture Capital Fund

The ITAT, Delhi, in *ACIT v. Drishti Soft Solutions Pvt. Ltd. [ITA No. 8523/Del/2019 dated February 10, 2023]* upheld the order passed by the Commissioner of Income Tax (Appeals) (“**CIT(A)**”) and dismissed the appeal filed by the Revenue Department and held that no tax would be levied on the issue of shares to venture capital fund and further upheld the observation of CIT(A) that, payment for valuation certification and retainership fees to a CA firm is a revenue expenditure.

### Facts:

Drishti Soft Solutions Pvt. Ltd. (“**the Respondent**”) is a company engaged in the business of software development and had electronically filed its return of income for the Assessment Year (“**A.Y.**”) 2016-17 on October 17, 2016, declaring total income at INR 1,69,85,280/-, which was selected for scrutiny and thereafter, assessment was framed under Section 143(3) of the Income Tax Act, 1961 (“**the IT Act**”). On December 20, 2018, Order-in-Original (“**the OIO**”) was passed by the Revenue Department (“**the Appellant**”), wherein the total income was determined at INR 24,26,59,340/-. The addition was made on the following grounds a) premium on the issue of shares shall be taxable and b) expense incurred on valuation certification is a capital expenditure.

With respect to the first ground, the Appellant, during the investigation, found out that the Respondent had raised INR 24,99,98,288/- by issuing 2,01,402 shares to M/s. Forum Synergies India Trust (“**FSIT**”) is a venture capital fund. Thereafter, the Respondent was asked to furnish the justification of funds received in the form of share premium, for which the Respondent submitted the valuation report, which was not found acceptable to the Appellant as it was noted that the Respondent’s CA had used Discounted Cash Flow Method for valuing shares which was not realistic and did not match with the actual financial condition of the Respondent. The Appellant post calculating the valuation of shares as per Rule 11UA of the

Income Tax Rules, 1962 (“**the IT Rules**”) added INR 21,57,85,188/- to the income of the Respondent under the head of income from other sources.

In respect to the second ground, it was found during the investigation proceedings that the Respondent has paid INR 1,36,000/- to a CA firm on account of Professional fee for share valuation certificate. The Respondent submitted that the amount was towards monthly retainership fees and professional fees for the PE Fund's valuation. Thus, they are fully allowable under Section 37 of the IT Act. The Appellant held that the expense was not in the nature of routine business expenses but in the nature of capital expenses and therefore, the addition of INR 1,36,000/- was made to the income.

Being aggrieved by the OIO, an appeal was filed by the Respondent before the CIT(A), who vide Order-in-Appeal dated September 19, 2019 (“**the OIA**”) granted substantial relief to the Respondent.

Hence, this appeal has been filed by the Appellant.

**Issues:**

1. Whether the CIT(A) has erred in deleting the addition of INR 21,57,85,188/- on account of share premium valuation?
2. Whether the CIT(A) has erred in deleting the addition of INR 1,36,000/- being expense for valuation certification under Section 37(1) of the IT Act?

**Held:**

The ITAT, Delhi in ***ITA No. 8523/Del/2019*** held as under:

- Observed that, FSIT is a venture capital fund thus, as per the proviso to Section 56(2) (viib) of the IT Act which states that the said provision does not apply on the consideration for issue of shares by a venture capital undertaking from a venture

capital fund therefore, the provision of Section 56(2) (viib) of the IT Act would not be applicable on the consideration of issuance of shares by the Respondent.

- Held that, the CIT(A) has not erred in deleting the addition of INR 21,57,85,188/- on account of share premium.
- Further observed that, the retainership fees paid to CA firm by the Respondent have been incurred during the regular course of business and cannot be treated as capital expenses.
- Noted that, the Appellant has not pointed to any fallacy in the findings of CIT(A).
- Held that, the CIT(A) has not erred in deleting the addition of INR 1,36,000/- being expense for valuation certification under Section 37(1) of the IT Act.

#### **Relevant Provisions:**

##### **Section 56(2) (viib) of the IT Act:**

*“(viib) where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares:*

*Provided that this clause shall not apply where the consideration for issue of shares is received-*

*(i) by a venture capital undertaking from a venture capital company or a venture capital fund or a specified fund; or*

*(ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf.*

*Provided further that where the provisions of this clause have not been applied to a company on account of fulfilment of conditions specified in the notification issued under clause (ii) of the first proviso and such company fails to comply with any of those conditions, then, any consideration received for issue of share that exceeds the fair market value of such share shall be deemed to be the income of that company chargeable to income-tax for the previous year in which such failure has taken place and, it shall also be deemed that the company has under reported the income] in consequence of the misreporting referred to in sub-section (8) and sub-section (9) of section 270A for the said previous year.*

*Explanation.-For the purposes of this clause,-*

*(a) the fair market value of the shares shall be the value-*

*(i) as may be determined in accordance with such method as may be prescribed; or*

*(ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of its assets, including intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature,*

*whichever is higher;”*

**Section 37(1) of the IT Act:**

*“General-*

*(1) Any expenditure(not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".*

*Explanation 1-For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.*

*Explanation 2.-For the removal of doubts, it is hereby declared that for the purposes of sub-section (1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.*

*Explanation 3.-For the removal of doubts, it is hereby clarified that the expression "expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law" under Explanation 1, shall include and shall be deemed to have always included the expenditure incurred by an assessee,-*

*(i) for any purpose which is an offence under, or which is prohibited by, any law for the time being in force, in India or outside India; or*

*(ii) to provide any benefit or perquisite, in whatever form, to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guideline, as the case may be, for the time being in force, governing the conduct of such person; or*

(iii) to compound an offence under any law for the time being in force, in India or outside India.”

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