IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.299 OF 2021
WITH
INCOME TAX APPEAL NO.300 OF 2021

Shendra Advisory Services P. Ltd.)
Knowledge House, Shyam Nagar,)
Off Jogeshwari Vikhroli Link Road,)
Jogeshwari (East), Mumbai – 400 060) ….Appellant

V/s.

The Deputy Commissioner of Income Tax,)
Range 14(3)(2), Room No.455, 4th Floor,)
Aayakar Bhavan, M.K. Road, Mumbai – 400)
020) ….Respondent

Mr. R.A. Dada, Senior Advocate a/w. Mr. Nishant Thakkar, Mr. Zubair Dada, Mr. Hiten Thakkar, Ms. Sofiya Shanmugam and and Mr. Bhavesh Bhatia i/b. Lumiere Law Partners for appellant.
Mr. Suresh Kumar for respondent.

CORAM : K. R. SHRIRAM &
DR. NEELA GOKHALE, JJ.
DATED : 9th FEBRUARY 2024

ORAL JUDGMENT : (PER K.R. SHRIRAM, J.) :

1 Both these appeals are filed under Section 260A of the Income Tax Act, 1961 (the Act) impugning an order dated 17th September 2019 passed by the Income Tax Appellate Tribunal (ITAT) dismissing appellant's appeals.

These appeals came to be admitted on 16th March 2023 and the following substantial questions of law were framed :

> *(i) Whether, on the facts and in the circumstances of the case, and in law, the Tribunal erred in setting aside the appeal, on the ground that the Assessing Officer is directed to examine whether there is violation of the provision of section 78 of the Companies Act, 1956 with regard to the utilization of share premium account?*

> *(ii) Whether, on the facts and in the circumstances of the case, and in law, the order of the Tribunal is perverse inasmuch as it is based on extraneous, impermissible and irrelevant considerations, while ignoring the relevant material and considerations?*

2 Mr. Dada stated that answering the first question would take care of the second question also. Mr. Dada further stated that in question no.1, the words "*in setting aside the appeal*" should be corrected to read as "*in dismissing the appeal*".

3 Appellant, i.e., the assessee, was a joint venture between Indian Promoters, viz., Pantaloons Retail India Limited (PRIL), Pantaloon Industries Limited (PIL) [for ease of reference referred to as "Future Group"] and M/s. Participatie Maatschappij Graafsshap Holland NV (PMG), a company incorporated under the laws of Netherland. Appellant was also a promoter of an insurance company called Future Generali India Insurance Company Limited. As a part of the joint venture arrangement and agreed business strategy, PIL, which was an Indian entity, was to be issued shares at par at Rs.10/- each while PMG, being a foreign promoter, was to infuse funds at a premium of Rs.2490/- per share. The shares were issued to PIL at Rs.10/- each and PMG at Rs.2500/- per share. Both the joint venture partners were happy with that arrangement as that is what the joint venture agreement provided for.

4 From Assessment Year 2008-2009 to Assessment Year 2012-2013 appellant/assessee issued various quantities of shares on different dates to the promoters. All the inward remittances as well as issuance of shares were in accordance with the laws, regulations and rules including the Foreign Exchange Management Act, 1999 (FEMA) and the RBI guidelines. Appellant also complied with legal and procedural requirements for issue of shares as laid down under the Foreign Direct Investment (FDI) Scheme as indicated in notification issued by the RBI. The investment made by PMG was also within the sectoral policy/cap permissible under the automatic route of RBI. PMG still holds shares in the assessee's company as on date. These facts have not been disputed or controverted by the Revenue.

5 During the scrutiny assessment proceedings for Assessment Year 2009-2010, the issue of share capital was raised by the Assessing Officer who issued various notices from time to time. Appellant responded to the said notices. After considering the various details and submissions filed by appellant, the Assessing Officer found the issue of share capital as proper and genuine and no addition was made in the order dated 29th December 2011 passed under Section 143(3) of the Act for Assessment Year 2009-2010. Similarly for Assessment Year 2010-2011 also the issue of share capital came up for consideration during the assessment proceedings and the explanation given by appellant was accepted and an assessment

order dated 4th March 2013 under Section 143(3) of the Act for Assessment Year 2010-2011 came to be passed.

6 During the financial year corresponding to Assessment Year 2011-2012, which is the subject matter of this appeal, appellant had issued further shares. The books maintained by appellant also reflected receipt of share monies. It also included specific "Related Party Disclosure" as per Accounting Standard 18 issued by the Institute of Chartered Accountant of India. The audited accounts were also filed with the Registrar of Companies (ROC) and the same was accepted. The return of income filed by appellant for Assessment Year 2011-2012 came up for scrutiny assessment under Section 143(3) of the Act. The Assessing Officer called upon appellant to file various details. Appellant responded and vide letters dated 22nd November 2013, 26th November 2013, 5th December 2013, 12th December 2013 and 10th March 2014 filed various documents, furnished various details and tendered explanations.

7 The Assessing Officer, notwithstanding the view taken by the Revenue for Assessment Year 2009-2010 and 2010-2011 with regard to the share premium and issue of share capital, took a view in the assessment order dated 21st March 2014 passed under Section 143(3) of the Act that the entire share premium received amounting to Rs.47,88,27,000/- was unexplained cash credit under Section 68 of the Act and added the same to the income of appellant. This addition was made on two counts, viz.,

(a) there was no justification for charging share premium and (b) there was violation of the provisions of Section 78(2) of the Companies Act, 1956.

8 Aggrieved by the assessment order, appellant preferred an appeal before the Commissioner of Income Tax (Appeals) [CIT(A)]. During the proceedings before CIT(A) exhaustive submissions were also filed. Notwithstanding the same, CIT(A), by an order dated 1st March 2016, upheld the addition made by the Assessing Officer. This order was carried in appeal before the Income Tax Appellate Tribunal (ITAT) and the appeal came to be dismissed by the Tribunal vide impugned order dated 17th September 2019. The Tribunal did not accept the submissions of appellant and dismissed the appeal with a direction to the Assessing Officer to examine in detail the aspect as to whether there was violation of the provision of Section 78(2) of the Companies Act, 1956 with respect to the utilization of the share premium account.

9 Mr. Dada submitted as under :

(a) the Tribunal has arrived at its conclusion entirely on surmises, conjectures and suspicion without bringing on record any cogent material to support the conclusion;

(b) the factual aspects have not been disputed;

(c) the fact that the Assessing Officer had not doubted the entire transaction with regard to allotment of equity shares and receipt of the share premium amount but what was sought to be questioned was only

the receipt of the share premium amount which was said to be excessive and much beyond the intrinsic value of the shares of appellant company;

(d) just because the amount that was received by appellant company was invested would not amount to contravention to Section 78 of the Companies Act, 1956 because no company would keep its money idle;

(e) the ITAT as well as CIT(A) and the Assessing Officer have overlooked the fact that the share premium amount had not been depleted. If there was no difference in the balances, i.e., the opening balance plus newly infused share premium amount, how the conclusion has been drawn that the share premium money was utilized for business purposes and not preserved for the purposes for which it was collected has not been explained or even considered. Without any evidence all the authorities have held that the assessee had used the money for purposes other than the purposes for which it was collected;

(f) even assuming for the sake of argument that there was a breach of the provisions of Section 78 of the Companies Act, 1956, still it is settled law as held in ***Vodafone India Services (P) Ltd. V/s. Union of India***[1] that it would not make the premium of shares issued received on capital account transaction to income;

(g) the amendments incorporated in the definition of income under Section 2(24)(xvi) and Section 56(2)(viib) of the Act were amendments which were to apply only from 1st April, 2013, i.e., Assessment

1 (2014) 50 taxmann.com 300 (Bombay)

Year 2013-2014 and the amendment to Section 68 by incorporation of the first proviso also came into effect by virtue of the Finance Act, 2012, w.e.f., 1st April 2019 and was to apply for the Assessment Year 2013-2014 and onwards. Since the amendments were not applicable to the assessment year in question, i.e., 2010-2011, there would be no basis for the Assessing Officer to treat the share premium amount as income. Of course Mr. Dada also added that this was not even an issue in the assessment order passed;

(h) the ITAT itself in ***Credit Suisse Business Analysis (India) (P.) Ltd. V/s. Assistant Commissioner of Income Tax, Circle 15(1)(2), Mumbai***[2] has held that even the inclusive definition of income does not stipulate that non compliance of any provision of other Act would result in turning a capital receipt a revenue receipt. This finding of its co-ordinate bench has been ignored by the ITAT in the impugned order. Similarly, the ITAT has also ignored the order in ***Deputy Commissioner of Income Tax 1(1)(2), Mumbai V/s. Finproject India (P.) Ltd.***[3] where the ITAT observed that the Assessing Officer erred in not distinguishing what is meant by utilization of the funds being proceeds of share premium raised for the specified approved purposes and the creation of share premium account in the books of accounts for share premium received.

10 Mr. Suresh Kumar submitted as under :

(a) the balance sheet revealed that the company was making

2 (2016) 72 taxmann.com 131 (Mumbai-Trib.)
3 (2018) 93 taxmann.com 461 (Mumbai-Trib.)

long term investment in equity shares of Future Generali India Insurance Company Limited and the profit and loss account for the assessment year has shown a fixed income of Rs.90,000/- from consultancy services and loss of Rs.59,87,173/-. Therefore, there was no justification to charge a premium. The premium charged was excessive and much beyond the intrinsic value of the shares of appellant company;

(b) only PMG was made to pay premium of Rs.2490/- whereas PIL was not paying any premium and, therefore, the Assessing Officer was justified in treating the share premium paid by PMG as unexplained cash credit under Section 68 of the Act;

(c) appellant breached the provisions of Section 78 of the Companies Act, 1956 because Section 78 places restriction on the application of share premium money. Therefore, the company having violated provisions of Section 78 of the Companies Act, 1956, the Assessing Officer was justified in treating the share premium amount as unexplained cash credit under Section 68 of the Act.

FINDINGS :

11 The issue at hand is very narrow. Whether the money received as premium of share issued on account of a capital account transaction can give rise to income?

In ***SLS Energy (P) Ltd. V/s. Income Tax Officer*** [4] the Court considered whether the receipt of premium on issuance of shares was

4 (2023) 154 taxmann.com 400 (Bombay)

receipt of income and came to a finding that the receipt of premium on issuance of shares was not receipt of income but was a capital receipt. The Court came to a finding that the receipt of share capital including the premium was on capital account and gave rise to no income. It will be useful to reproduce paragraphs 24 to 30 of *SLS Energy (P) Ltd.* (Supra) which read as under :

> *"24. In the present case neither the reasons recorded nor the order disposing of the objections in any manner reflects that there was any doubt with regard to existence of the entities in whose favour the allotment of shares had been made upon receipt of share money as also the amount of premium paid on the said shares.*
>
> *25. By virtue of the impugned notice dated 23rd March, 2015, the assessing officer seeks to reopen the assessment for the assessment year 2010-11, which is within a period of four years. Admittedly, no scrutiny assessment under section 143(3) of the Act has taken place in the present case. Even in a case where no scrutiny assessment has taken place, reassessment can be ordered only if the assessing officer has reason to believe that income chargeable to tax had escaped assessment. The Apex Court in Asstt. CIT v. Rajesh Jhaveri Stock Brokers(P.)Ltd.[2007] 161 Taxman 316/291 ITR 500 (SC) has clearly held that notice for reopening an assessment under section 148 of the Act could only be justified if the Assessing Officer has reason to believe that income chargeable to tax has escaped assessment.*
>
> *26. The reason for the assessing officer to reopen the assessment is his belief that the share premium charged by the Petitioner was excessive and further that the transaction of the so called share premium was not established. In other words, the assessing officer apart from questioning the excessive share premium also is doubting the transaction, whereby the share premium had been received. Whether in the aforementioned facts the assessing officer could be said to have his reason to believe that income had escaped assessment and whether the material with the said assessing officer could be said to have any tangible material justifying the reopening is the issue that falls for our consideration.*
>
> *27. <u>There is no dispute that in Vodafone India Services (P.) Ltd .'s case (supra) it stands concluded that receipt of share capital including the premium was on capital account and gave rise to no income. The amendments incorporated in the</u>*

definition of income under section 2(24)(xvi) and Section 56(2)(viib) of the Act were amendments which were to apply only from 01st April, 2013 i.e. assessment year 2013-14. The amendment to Section 68 by incorporation of the first proviso also came into effect by virtue of the Finance Act, 2012 w.e.f. 1st April, 2019 and was to apply for the assessment year 2013-14 and onwards, and, therefore, since the amendments were not applicable to the assessment year in question i.e. 2010-11, there would be no basis for the assessing officer's reason to believe that income had escaped assessment for the said assessment year. From the record it can also be seen that the preference shares allotted to M/s. Pony Infrastructure & Contractors Ltd. (formerly known as M/s. Dynamix Balwas Infrastructure Pvt. Ltd.) was assessed under section 143(3) of the Act and an order of assessment dated 22nd February, 2013 was passed.

28. Reassessment proceedings were initiated against the said entity and the appeal allowed vide order dated 11th October, 2018. We therefore agree with the contention of Mr. Shridharan, learned Counsel for the Petitioner that this was not a case where there could be any suspicion with regard to the factum of transaction having taken place between two companies. In any case the assessing officer appears to have not been in doubt regarding the transaction having taken place between the said two companies with regard to allotment of preference shares and receipt of the share premium amount inasmuch as what was sought to be questioned, was not in fact the transaction, but only the receipt of the share premium amount which was said to be excessive and much beyond the intrinsic value of the shares of the Petitioner company.

29. This can be guessed from the fact that the assessing officer had only flagged the share premium amount of Rs.6,79,32,00,000/- which according to him was chargeable to tax that had escaped assessment and did not question the amount of Rs. 68 lakhs received by the Petitioner company representing the value of Rs. 68 lakhs shares of the face value of rupee 1 per share. Had the Assessing Officer any real doubts regarding the transaction itself, then there was no justification for him to question only the transaction with regard to the extent of the amount of premium charged for the said shares.

30. We therefore of the opinion that there was neither any basis for the assessing officer for his reason to believe that income had escaped assessment nor was there any tangible material which would have otherwise given jurisdiction to reopen the assessment even when the reopening was sought to be made within a period of four years."

(emphasis supplied)

Relying on the said judgment, this Court came to a finding in ***Godrej Projects Development Pvt. Ltd. V/s. Income Tax Officer, 1(1)(4) & Ors.***[5] that money received in share premium account can never give rise to income.

12 The charge of tax under the Act is on income. The receipt of share premium on the issue of fresh shares is on capital account and constitutes a capital receipt, which is not chargeable to tax under the Act. There is no provision under the Act to tax the receipt of share premium for the assessment year under consideration. As held in *Vodafone India Services (P) Ltd.* (Supra) the amount received on issue of shares is admittedly a capital account transaction not separately brought within the definition of income during the relevant period. Thus, capital account transaction not falling within the statutory explanation cannot be brought to tax.

13 After the judgment of *Vodafone India Services (P) Ltd.* (Supra) of this Court, the CBDT also issued instruction being Instruction No.2/2015 [F.NO.500/15/2014-APA-I] DATED 29th January 2015, which reads as under :

> *SECTION 92C OF THE INCOME TAX ACT, 1961 - TRANSFER PRICING - COMPUTATION OF ARM'S LENGTH PRICE - ACCEPTANCE OF ORDER OF HIGH COURT OF BOMBAY IN CASE OF VODAFONE INDIA SERVICES PVT. LTD. [2014] 50 TAXMANN.COM 300 (BOMBAY)*
>
> *INSTRUCTION NO.2/2015 [F.NO.500/15/2014-APA-I], DATED 29-1-2015*

5 2024 SCC Online Bom 366

> *In reference to the above cited subject, I am directed to draw your attention to the decision of the High Court of Bombay in the case of Vodafone India Services Pvt. Ltd. for A.Y. 2009-10 (WP No.871/2014), wherein the Court has held, inter-alia, that the premium on share issue was on account of a capital account transaction and does not give rise to income and, hence, not liable to transfer pricing adjustment.*
>
> *2. It is hereby informed that the Board has accepted the decision of the High Court of Bombay in the above mentioned Writ Petition. In view of the acceptance of the above judgment, it is directed that the ratio decidendi of the judgment must be adhered to by the field officers in all cases where this issue is involved. This may also be brought to the notice of the ITAT, DRPs and CsIT (Appeals).*
>
> *3. This issues with the approval of Chairperson, CBDT.*
>
> *(emphasis supplied)*

A press note dated 28th January 2015 was also issued accepting the order of this Court in *Vodafone India Services (P) Ltd.* (Supra), which reads as under :

> *Acceptance of the Order of the High Court of Bombay in the case of Vodafone India Services Private Limited*
>
> *xxxxxxxxxxxxxxx*
>
> *i. accept the order of the High Court of Bombay in WP No.871 of 2014, dated 10.10.2014, and not to file SLP against it before the Supreme Court of India:*
>
> *xxxxxxxxxxxxxxx*
>
> *The Cabinet decision will bring greater clarity and predictability for taxpayers as well as tax authorities, thereby facilitating tax compliance and reducing litigation on similar issues. This will also set at rest the uncertainty prevailing in the minds of foreign investors and taxpayers in respect of possible transfer pricing adjustments in India on transactions related to issuance of shares, and thereby improve the investment climate in the country.*
>
> *The Cabinet came to this view as this is a transaction on the capital account and there is no income to be chargeable to tax. So applying any pricing formula is irrelevant.*

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c) The tax can be charged only on income and in the absence of any income arising, the issue of applying the measure of Arm's Length Pricing to transactional value/consideration itself does not arise."

d) If its income which is chargeable to tax, under the normal provisions of the Act, then alone Chapter X of the Act could be invoked. Sections 4 and 5 of the Act brings/charges to tax total income of the previous year. This would take us to the meaning of the word income under the Act as defined in Section 2 (24) of the Act. The amount received on issue of shares is admittedly a capital account transaction not separately brought within the definition of Income, except in cases covered by Section 56(2)(viib) of the Act. Thus such capital account cannot be brought to tax as already discussed herein above while considering the challenge to the grounds as mentioned in impugned order."

e) The issue of shares at a premium is on Capital account and gives rise to no income. The submission on behalf of the revenue that the shortfall in the ALP as computed for the purposes of Chapter X of the Act is misplaced. The ALP is meant to determine the real value of the transaction entered into between AEs. It is a re-computation exercise to be carried out only when income arises in case of an International transaction between AEs. It does not warrant re-computation of a consideration received/given on capital account.

(emphasis supplied)

Therefore, one thing is certain that share premium received by issuance of shares is on capital account and gives rise to no income.

14 The ITAT in *Credit Suisse Business Analysis (India) (P.) Ltd.* (Supra) in paragraph 5 held as under :

5. We have heard the rival submissions and perused the material on record. We find that the FAA had up- held the disallowance because he was of the opinion that the assessee had not violated the provisions of CA. In other words, if the assessee had not contravened the section 78 or 100 of the CA, the amount in question would not have been liable to tax. In our opinion, the approach of the FAA is fundamentally wrong. The taxability of an amount has to be decided within

the four corners of the Income Tax, Section 4 of the Act is the charging section and section 2 defines the word income. Even the inclusive definition of income does not stipulate that non-compliance of any provision of other Act would result in turning a capital receipt a revenue receipt. An infringement of a particular Act is dealt by that Act, unless and until it deals with other Act/(s). For example provisions of Prevention of Money Laundering Act (PMLA)provide that certain of fences committed under other statutes would be considered scheduled offence under the PMLA. Without such a clear mandate nothing can be imported to be implemented to other Act/(s). While dealing with the assessment or appeals, under the provisions of the Income-tax Act, the basic principle every officer of the department has to remember that he is the representing the Sovereign and his duty is to collect Due taxes only. For determining the Due taxes they should avoid bringing far-fetched fancies and ideas. In the case under consideration they have done the same. Without understanding the basic philosophy of income they have referred to the provisions of CA, so that the amount in question can be taxed at any cost. It is not a fair or judicious approach to deal with the Subjects of the State. Even if the assessee had violated the provisions of CA, it will be penalised by the provisions of that Act. But, it would never turn a capital receipt into revenue receipt or vice versa.

Now, we would also like to discuss the provision of sections 78 and 100 of the CA also. But, before testing the applicability of the said sections, we would like to refer to the submissions made by the assessee in that regard. Neither the AO nor the FAA has proved that the share premium money was utilised by it for running its day-to-day business. The assessee had proved that the opening and the closing balance of the share premium money account was same for the year under consideration. We find that the factual position assailed by the assessee was not proved incorrect by both the authorities. If there was no difference in the balances how the conclusion was drawn that the share premium money was utilised for business purposes and not preserved for the purposes for which it was collected. Without any evidence both the authorities held that the assessee had used the money for purposes other than the purposes for which it was collected. Therefore, in our opinion there was no foundation of the building that was built by them. We are not in a position to validate such a classical factual blunder. Section 100 of the CA deals with reduction of share capital, In short, the stand taken by the FAA is not endorseable either legally nor factually. We would also like to mention that the facts of the case of T.V. Sundaram Iyengar & Sons Ltd.(supra), relied upon by the FAA, has not relevance to decide the issue before us. It does not deal with the issue of share premium money and its taxability. So, considering the facts and circumstances

> *of the case, we are reversing the order of the FAA. Effective ground of appeal is decided in favour of the assessee.*
>
> *(emphasis supplied)*

15 Therefore, since the Act does not stipulate that non compliance of any provision of other Act would result in turning a capital receipt into a revenue receipt, even assuming for the sake of argument that appellant had breached the provisions of Section 78(2) of the Companies Act, 1956, it would not turn the share premium amount received into a revenue receipt. As observed in *Credit Suisse Business Analysis (India) (P.) Ltd.* (Supra), for determining the due taxes, the Assessing Officer should avoid bringing far-fetched fancies and ideas. In the case under consideration they have done the same. Without understanding the basic philosophy of income they have referred to the provisions of Companies Act, 1956 so that the amount in question can be taxed at any cost. It is not a fair or judicious approach to deal with the subjects of the State. Even if the assessee had violated the provisions of Companies Act, 1956, it will be penalised by the provisions of that Act and it would never turn a capital receipt into revenue receipt or vice versa. There is nothing on record from the balance sheet filed that the share premium amount has been utilized for purposes other than what is prescribed in Section 78(2) of the Companies Act, 1956. Just because the amount has been invested does not mean that the amount has been utilized for purposes other than what is prescribed in Section 78(2) of the Companies Act, 1956.

16 We are satisfied that the closing balance and the opening balance of the share premium money only indicates that there is an increase in the share premium account by way of infusion of funds and not depletion. There is nothing to indicate that the assessee has used the share premium money to invest in shares. The Assessing Officers have failed to understand the difference between utilization of funds and creation of share premium account in the books of accounts for the share premium receipt which was also the case in *Finproject India (P.) Ltd.* (Supra).

17 The reliance by ITAT on ***Bharat Fire & General Insurance Ltd. V/s. Commissioner of Income Tax***[6] is also misplaced in as much as that was a case where the company had declared a dividend out of the capital reserve and the Court was considering how that amount has to be dealt with after coming into force of the Companies Act, 1956.

18 In view of the above, the impugned orders in both appeals have to be quashed and set aside, which we hereby do. The question of law as framed is answered in the affirmative.

19 Both appeals disposed accordingly.

(DR. NEELA GOKHALE, J.) **(K. R. SHRIRAM, J.)**

6 (1964) 53 ITR 108 (SC)