IN THE INCOME TAX APPELLATE TRIBUNAL
"A" BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND
Ms. PADMAVATHY S, ACCOUNTANT MEMBER

ITA No.1739/Bang/2019
Assessment year : 2013-14

UKN Properties Pvt. Ltd., No.12, 1st Floor, St. Patricks Shopping Arcade, Residency Road, Bangalore – 560 025. **PAN: AAACU 3584A**	Vs.	The Deputy Commissioner of Income Tax, Circle 7(1)(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Narendra Sharma, Advocate
Respondent by	:	Shri V S Chakrapani, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	14.09.2022
Date of Pronouncement	:	16.09.2022

O R D E R

Per Padmavathy S., Accountant Member

This appeal by the assessee is against the order of CIT(Appeals)-7, Bangalore dated 18.3.2019 for the assessment year 2013-14.

2. The following issues arise out of the various grounds raised by the assessee:-

1. Disallowance us. 14A – Rs.84,78,588.
2. Addition towards prior period items – Rs.25,51,882.
3. Addition u/s. 56(2)(vii) – Rs.6,95,35,940.

3. The assessee is engaged in the business of real estate development . The assessee filed a return of income for the AY 2013-14 on 26.9.2013 by declaring total income of Rs.84,00,220. The case was selected for scrutiny and a notice u/s. 143(2) was duly served on the assessee. The assessment was concluded by making the above disallowances/additions. The assessee filed an appeal before the CIT(Appeals), who upheld the order of the AO. Aggrieved, the assessee is in appeal before the Tribunal.

Disallowance u/s. 14A r.w.s Rule 8D

4. During the assessment proceedings, the AO noticed that the assessee has made huge investments in the equity shares of various concerns. The AO invoked the provisions of section 14A and called for details from the assessee. The assessee submitted that no expenditure relatable to exempt income was debited to the P&L Account and that the company has advanced money out of non-interest funds and hence disallowance u/s. 14A is not applicable. However, the AO proceeded to compute the disallowance u/s. 14A r.w. Rule 8D(2)(ii) and Rule 8D2(iii) and made a disallowance of Rs.84,78,588. Aggrieved, the assessee preferred an appeal before the CIT(Appeals).

5. Before the CIT(Appeals), the assessee submitted that the interest debited to the P&L account is attributable entirely towards the purpose of business of the assessee. The assessee further submitted that the entire investment is out of the internal approvals the break-up of which is as given below:-

Particulars	Amount (Rs.)
Share Capital	17,19,00,000
Reserves & surplus	5,54,22,450
Advance received for properties	14,88,75,190
Security deposits	2,35,87,849
Loan from sister concerns	18,33,13,450
Total	**57,30,98,939**

6. The assessee therefore submitted that the interest free source is more than the investments made by the assessee and therefore no disallowance is warranted u/s. 14A. The CIT(A) rejected the submissions of the assessee and confirmed the disallowance made by the AO. The CIT(A) in this regard relied on the decision of the Karnataka High Court in the case of *Pradeep Kar, 319 ITR 416* and also the decision of Hon'ble Supreme Court in the case of *Maxopp Investments Ltd., 91 taxmann.com 154.*

7. Before us, the ld. AR reiterated the submissions made before the lower authorities. The ld. AR also submitted that the assessee is not having any exempt income that is offered to tax and therefore the question of disallowance u/s. 14A does not arise. The ld. AR in this regard relied on the decision of the coordinate Bench of the Tribunal in

the case of *M/s. Atria Power Corporation Pvt. Ltd. v. ITO, ITA No376/Bang/2020 dated 10.8.2022.*

8. The ld. DR supported the orders of the lower authorities.

9. We have heard the rival submission and perused the material on record. The Hon'ble Delhi High Court in the case of *Era Infrastructure (India) Ltd., [2022] 141 taxmann.com 289* has considered the issue of disallowance u/s.14A when there is no exempt income and held that no disallowance under section 14A of the Act could be made if no exempt income was earned by the assessee. The relevant part of the judgment is as under:-

> "9. Though the judgment of this Court has been challenged and is pending adjudication before the Supreme Court, yet there is no stay of the said judgment till date. Consequently, in view of the judgments passed by the Supreme Court in Kunhayammed v. State of Kerala (2000] 113 Taxman 470/245 ITR 360 and Shree Chamundi Mopeds Ltd. v. Church of South India Trust Association [1992] 3 SCC 1, the present appeal is dismissed being covered by the judgment passed by the learned predecessor Division Bench in IL & FS Energy Development Co. Ltd. (supra) and Cheminvest Ltd. v. CIT [2015] 61 taxmann.com 118/234 Taxman 761/378 ITR 33 (Delhi).
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> 10. Accordingly, the appeal and application are dismissed. However, it is clarified that the order passed in the present appeal shall abide by the final decision of the Supreme Court in the SLP filed in the case of IL & FS Energy Development Co. Ltd. (supra)".

10. The Hon'ble Delhi Court in the above has also considered the amendment to section 14A and has held that the explanation inserted to

section 14A vide Finance Act 2022 is prospective in nature. The relevant observations are reproduced here under –

> "5. However a perusal of the Memorandum of the Finance Bill, 2022 reveals that it explicitly stipulates that the amendment made to section 14A will take effect from 1st April, 2022 and will apply in relation to the assessment year 2022-23 and subsequent assessment years. The relevant extract of Clauses 4, 5, 6 & 7 of the Memorandum of Finance Bill, 2022 are reproduced hereinbelow:
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> > "4. In order to make the intention of the legislation clear and to make it free from any misinterpretation, it is proposed to insert an Explanation to section 14A of the Act to clarify that notwithstanding anything to the contrary contained in this Act, the provisions of this section shall apply and shall be deemed to have always applied in a case where exempt income has not accrued or arisen or has not been received during the previous year relevant to an assessment year and the expenditure has been incurred during the said previous year in relation to such exempt income.
> >
> > 5. This amendment will take effect from 1st April, 2022.
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> > 6. It is also proposed to amend sub-section (1) of the said section, so as to include a non-obstante clause in respect of other provisions of the Income-tax Act and provide that no deduction shall be allowed in relation to exempt income, notwithstanding anything to the contrary contained in this Act.
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> > *7. This amendment will take effect from 1st April, 2022 and will accordingly apply in relation to the assessment year 2022-23 and subsequent assessment years."*
> >
> > (emphasis supplied)
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> 6. Furthermore, the Supreme Court in Sedco Forex International Drill. Inc. v. CIT [2005] 149 Taxman 352/279 ITR 310 has held that a retrospective provision in a tax act which is "for the removal of doubts" cannot be presumed to be retrospective, even where such language is used, if it alters or changes the law as it earlier stood. The relevant extract of the said judgment is reproduced hereinbelow:
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> > '9. The High Court did not refer to the 1999 Explanation in upholding the inclusion of salary for the field break periods in the assessable income of the employees of the appellant. However, the respondents have urged the point before us.

10. In our view the 1999 Explanation could not apply to assessment years for the simple reason that it had not come into effect then. Prior to introducing the 1999 Explanation, the decision in CIT v. S.G. Pgnatale [(1980) 124 ITR 391 (Guj.)] was followed in 1989 by a Division Bench of the Gauhati High Court in CIT v. Goslino Mario [(2000) 241 ITR 314 (Gau.)]. It found that the 1983 Explanation had been given effect from 1-4-1979 whereas the year in question in that case was 1976-77 and said: (ITR p. 318)
"[I]t is settled law that assessment has to be made with reference to the law which is in existence at the relevant time. The mere fact that the assessments in question has (sic) somehow remained pending on 1-4-1979, cannot be cogent reason to make the Explanation applicable to the cases of the present assessees. This fortuitous circumstance cannot take away the vested rights of the assessees at hand. "

11. The reasoning of the Gauhati High Court was expressly affirmed by this Court in CIT v. Goslino Mario [(2000) 10 SCC 165 : (2000) 241 ITR 312] . These decisions are thus authorities for the proposition that the 1983 Explanation expressly introduced with effect from a particular date would not effect the earlier assessment years.

12. In this state of the law, on 27-2-1999 the Finance Bill, 1999 substituted the Explanation to Section 9(1)(ii) (or what has been referred to by us as the 1999 Explanation). Section 5 of the Bill expressly stated that with effect from 1-4-2000, the substituted Explanation would read:
"Explanation.-For the removal of doubts, it is hereby declared that the income of the nature referred to in this clause payable for—
(a) service rendered in India; and
(b) the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment, shall be regarded as income earned in India."
The Finance Act, 1999 which followed the Bill incorporated the substituted Explanation to Section 9(1)(ii) without any change.

13. The Explanation as introduced in 1983 was construed by the Kerala High Court in CIT v. S.R. Patton [(1992) 193 ITR 49 (Ker.)] while following the Gujarat High Court's decision in S.G. Pgnatale [(1980) 124 ITR 391 (Guj.)] to hold that the Explanation was not declaratory but widened the scope of Section 9(1)(ii). It was further held that even

if it were assumed to be clarificatory or that it removed whatever ambiguity there was in Section 9(1)(ii) of the Act, it did not operate in respect of periods which were prior to 1-4-1979. It was held that since the Explanation came into force from 1-4-1979, it could not be relied on for any purpose for an anterior period.

14. In the appeal preferred from the decision by the Revenue before this Court, the Revenue did not question this reading of the Explanation by the Kerala High Court, but restricted itself to a question of fact viz. whether the Tribunal had correctly found that the salary of the assessee was paid by a foreign company. This Court dismissed the appeal holding that it was a question of fact. (CIT v. SR Patton [(1998) 8 SCC 608] .)

15. Given this legislative history of Section 9(1)(ii), we can only assume that it was deliberately introduced with effect from 1-4-2000 and therefore intended to apply prospectively [See CIT v. Patel Bros. & Co. Ltd., (1995) 4 SCC 485, 494 (para 18) : (1995) 215 ITR 165]. It was also understood as such by CBDT which issued Circular No. 779 dated 14-9-1999 containing Explanatory Notes on the provisions of the Finance Act, 1999 insofar as it related to direct taxes. It said in paras 5.2 and 5.3.
"5.2 The Act has expanded the existing Explanation which states that salary paid for services rendered in India shall be regarded as income earned in India, so as to specifically provide that any salary payable for the rest period or leave period which is both preceded and succeeded by service in India and forms part of the service contract of employment will also be regarded as income earned in India.
5.3 This amendment will take effect from 1-4-2000, and will accordingly, apply in relation to Assessment Year 2000-2001 and subsequent years".

16. The departmental understanding of the effect of the 1999 Amendment even if it were assumed not to bind the respondents under section 119 of the Act, nevertheless affords a reasonable construction of it, and there is no reason why we should not adopt it.

17. As was affirmed by this Court in Goslino Mario [(2000) 10 SCC 165 : (2000) 241 ITR 312] a cardinal principle of the tax law is that the law to be applied is that which is in force in the relevant assessment year unless otherwise provided expressly or by necessary implication.

(See also Reliance Jute and Industries Ltd. v. CIT [(1980) 1 SCC 139 : 1980 SCC (Tax) 67].) An Explanation to a statutory provision may fulfil the purpose of clearing up an ambiguity in the main provision or an Explanation can add to and widen the scope of the main section [See Sonia Bhatia v. State of UP., (1981) 2 SCC 585, 598 : AIR 1981 SC 1274, 1282 para 24]. If it is in its nature clarificatory then the Explanation must be read into the main provision with effect from the time that the main provision came into force [See Shyam Sunder v. Ram Kumar, (2001) 8 SCC 24 (para 44); Brij Mohan Das Laxman Das v. CIT, (1997) 1 SCC 352, 354; CIT v. Podar Cement (P.) Ltd., (1997) 5 SCC 482, 506]. But if it changes the law it is not presumed to be retrospective, irrespective of the fact that the phrases used are "it is declared" or "for the removal of doubts".' (emphasis supplied)

7. The aforesaid proposition of law has been reiterated by the Supreme Court in M.M. Aqua Technologies Ltd. v. CIT [2021] 129 taxmann.com 145/282 Taxman 281/436 ITR 582. The relevant portion of the said judgment is reproduced hereinbelow:—

"22. Second, a retrospective provision in a tax act which is "for the removal of doubts" cannot be presumed to be retrospective, even where such language is used, if it alters or changes the law as it earlier stood. This was stated in Sedco Forex International Drill Inc. v. CIT, (2005) 12 SCC 717 as follows :

17. As was affirmed by this Court in Goslino Mario [(2000) 10 SCC 165] a cardinal principle of the tax law is that the law to be applied is that which is in force in the relevant assessment year unless otherwise provided expressly or by necessary implication. (See also Reliance Jute and Industries Ltd. v. CIT [(1980) 1 SCC 139].) An Explanation to a statutory provision may fulfil the purpose of clearing up an ambiguity in the main provision or an Explanation can add to and widen the scope of the main section [See Sonia Bhatia v. State of UP., (1981) 2 SCC 585]. If it is in its nature clarificatory then the Explanation must be read into the main provision with effect from the time that the main provision came into force [See Shyam Sunder v. Ram Kumar, (2001) 8 SCC 24; Brij Mohan Das Laxman Das v. CIT, (1997) 1 SCC 352; CIT v. Podar Cement (P.) Ltd., (1997) 5 SCC 482]. But if it changes the law it is not presumed to be retrospective, irrespective of the fact that the phrases used are "it is declared" or "for the removal of doubts".

18. There was and is no ambiguity in the main provision of section 9(1)(ii). It includes salaries in the total income of an assessee if the

> assessee has earned it in India. The word "earned" had been judicially defined in SG. Pgnatale [(1980) 124 ITR 391 (Guj.)] by the High Court of Gujarat, in our view, correctly, to mean as income "arising or accruing in India". The amendment to the section by way of an Explanation in 1983 effected a change in the scope of that judicial definition so as to include with effect from 1979, "income payable for service rendered in India".
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> 19. When the Explanation seeks to give an artificial meaning to "earned in India" and brings about a change effectively in the existing law and in addition is stated to come into force with effect from a future date, there is no principle of interpretation which would justify reading the Explanation as operating retrospectively." (emphasis supplied)
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> 8. Consequently, this Court is of the view that the amendment of section 14A, which is "for removal of doubts" cannot be presumed to be retrospective even where such language is used, if it alters or changes the law as it earlier stood.

11. Considering the fact that the assessee has not earned any exempt income during the year under consideration and respectfully following the decision of the Hon'ble Delhi High Court in the case of *Era Infrastructure India Ltd.* (supra) we hold that no disallowance is warranted u/s.14A and delete the disallowance made in this regard. This ground is allowed in favour of assessee.

Prior period expenses

12. The AO noticed from the Form 3CD report of the assessee that an amount of Rs.25,51,882 is shown as project expenses debited to the P&L account which is relating to prior period. The AO therefore disallowed the same for the reason that it is not allowable being a prior period expenditure.

13. The CIT(Appeals) confirmed the disallowance by stating that the assessee has not brought anything on record to substantiate the claim that the expenses became crystallized during the year and that these expenses are project expenses is not supported by any evidence.

14. Before us, the ld. AR submitted that the AO has made the addition merely based on the tax audit report but did not appreciate that the said expenditure is incurred in relation to one of the projects of the asse, a mall at Kamraj Road. The ld. AR also submitted that the details of such expenditure are already furnished before the AO which has not been considered by the AO. The ld AR further submitted that these expenditure are not debited to P&L a/c as contended by the lower authorities These expenses are incurred towards a project and therefore kept in capital work-in-progress during the year under consideration. The ld. AR therefore submitted that the project expenditure which is not debited to P & L a/c irrespective of the year in which it has crystallised cannot be disallowed. The ld. DR relied don he order of the lower authorities.

15. We have heard the rival submission and perused the material on record. We notice that the AO has made the addition based on what is stated in the 3CD report and has not discussed about examine the nature of expenditure in the assessment order. The CIT(Appeals) has also not considered the submissions of the assessee that the said expenditure is not debited to the P&L a/c of the assessee, but upheld the addition based on what is stated by the auditors in Form 3CD. The

key issue that needs to be verified with regard to the addition made towards project expenses is, whether the said expenditure is debited to the P&L account as mentioned in Form 3CD or capitalized in work-in-progress account as contended by the assessee. We therefore remit this issue back to the AO to examine factually whether the project expenses are debited to the P&L account or kept in work-in-progress based on evidence and decide the allowability accordingly. Needless to say that the assessee may be given opportunity of being heard.

Addition u/s. 56(2)(vii)(a)

16. During the course of assessment, the AO noticed that the assessee has invested in equity shares of two companies viz., M/s. Zebra Cross Resorts P. Ltd. And M/s. Waterline Hotels P. Ltd. In both these companies, the AO noticed that the assessee has purchased the shares at a price lower than the market value and therefore invoked the provisions of section 56(2)(viia) of the Act to make an addition of Rs.6,95,35,940 under the head 'income from other sources' by holding as under:-

> "7.1 The assessee company during the assessment year 2012-13 invested in equity shares of two companies namely, M/s. Zebra Cross Resorts Pvt. Ltd and M/s. Waterline Hotels Pvt. Ltd. In both these companies, the assessee has purchased shares at a price lower than the market value of the shares as under:

Sl.	Name of the company	PAN	No. of Shares	Face Value	Premium As per Market Value	Premium Paid	Premium Paid below the FMV	Shortfall to be brought to tax
1	M/s Zebra Cross Resorts Pvt. Ltd	AAACZ3383N	49930	10	448	190	258	1,28,81,940
2	M/s. Waterline Hotels Private Limited		13.00,000	10	208.58	165	43.58	5,66,54,000
	Total							6,95,35,940

7.2 The assessee was asked to explain why the provisions of section 56(2)(viia) of the Income-tax Act, 1961 should not be attracted in its case and the shortfall in payment of premium to the FMV of the shares should not be brought to tax in its case under the head 'Income from Other Sources'. In the case of M/s. Waterline 14otels Private Limited, a valuation Report has been submitted by the said company to its jurisdictional Assessing Officer wherein the FMV of the equity shares have been determined at Rs. 208.58 per share whereas; the assessee company has paid a premium of Rs. 165/- per equity shares for 13,00,000 equity shares, shortfall amounting to Rs. 5,66,54,000/-.

7.3 In the case of M/s. Zebra Cross Resorts Private Limited, the assessee has paid Rs. 1,28,81,940 lower than the FMV for purchase of the shares as above. Therefore, in accordance with the provisions of Section 56(2)(viia) of the Income-tax Act the total amount of Rs. 6,95,35,940/- is brought to tax wide e Head Income from Other Sources' and added to the Total income of the assessee."

17. The CIT(Appeals) confirmed the addition made by the AO.

18. Before us, the ld. AR submitted that that the only method for arriving at FMV for the purpose of section 56(2)(viia) is the book value as prescribed in Rule 11UA(1)(c)(b) which deals with the valuation of unquoted equity shares for the purpose of valuation under the said section. It is submitted by the ld.AR that the AO has relied on the valuation report given by the Chartered Accountant (pg. 67 & 71 of PB) for making the addition which is based on Discounted Cash Flow [DCF] method. The ld. AR further submitted that the DCF method is not the permissible method of valuation for the purpose of section 56(2)(viia) and therefore the AO's basis of arriving at the addition is not correct. It is also submitted that the AO ought to have followed the book value method as prescribed under the relevant Rule and should have compared the same with the issue price of the shares for the purpose of making any addition in this regard.

19. The ld. DR relied on the order of the lower authorities.

20. We have heard the rival submissions and perused the material on record. Before proceeding further, we will look at the provisions of section 56(2)(viia) and Rule 11UA(1)(c)(b) of the Rules:-

> "56. (1) Income of every kind 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 chargeable to income-tax under any of the heads specified in section 14, items A to E.

(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head "Income from other sources", namely :—

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(viia) where a firm or a company not being a company in which the public are substantially interested, receives, in any previous year, from any person or persons, on or after the 1st day of June, 2010 but before the 1st day of April, 2017, any property, being shares of a company not being a company in which the public are substantially interested,—

(i) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;

(ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration :

Provided that this clause shall not apply to any such property received by way of a transaction not regarded as transfer under clause (via) or clause (vic) or clause (vicb) or clause (vid) or clause (vii) of section 47.

Explanation.—For the purposes of this clause, "fair market value" of a property, being shares of a company not being a company in which the public are substantially interested, shall have the meaning assigned to it in the Explanation to clause (vii);"

Rule 11UA(1)(c)(b)

"11UA. [(1)] For the purposes of section 56 of the Act, the fair market value of a property, other than immovable property, shall be determined in the following manner, namely,—

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****

(*c*) valuation of shares and securities,—

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(b) the fair market value of unquoted equity shares shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner, namely:—

the fair market value of unquoted equity shares =(A+B+C+D - L)× (PV)/(PE), where,

A= book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance-sheet as reduced by,—

(i) any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any; and

(ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

B = the price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer;

C = fair market value of shares and securities as determined in the manner provided in this rule;

D = the value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property;

L= book value of liabilities shown in the balance sheet, but not including the following amounts, namely:—

(i) the paid-up capital in respect of equity shares;

(ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;

(iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;

(iv) any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount

of income-tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;

(v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;

(vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PV= the paid up value of such equity shares;

PE = total amount of paid up equity share capital as shown in the balance-sheet;]

21. A combined reading of the section and the relevant rules makes it clear that for the purpose of arriving at the fair market value of unquoted shares, the book value of the assets should be considered as prescribed in Rule 11UA(1)(c)(b). We notice that the AO has relied on the valuation report given by the CA which is based on DCF method for making the addition in the hands of the assesse u/s. 56(2)(viia). The DCF method is not the prescribed method of valuation in accordance with Rule 11UA for the purpose of section 56(2)(viia) and the Act provides a separate Rule i.e., Rule 11UA(1)(c)(b) for this purpose which is the fair market value. The AO therefore should have computed the fair market value of the unquoted shares based on the method prescribed as per the above Rule and should have calculated the disallowance u/s. 56(2)(viia). We therefore remit the issue back to the AO to recomputed the value of the shares of M/s. Zebra Cross Resorts P. Ltd. and M/s. Waterline Hotels P. Ltd. and arrive at the addition, if any, warranted u/s. 56(2)(viia). The assessee is directed to provide the necessary information as may be required in this regard

before the AO and cooperate with the proceedings. It is ordered accordingly.

22. In the result, the appeal by the assessee is partly allowed.

Pronounced in the open court on this 16th day of September, 2022.

Sd/-	Sd/-
(N V VASUDEVAN) VICE PRESIDENT	(PADMAVATHY S) ACCOUNTANT MEMBER

Bangalore,
Dated, the 16th September, 2022.

/Desai S Murthy /

Copy to:

1. Appellant 2. Respondent 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.