

Kolkata Tribunal holds that Section 56(2)(viib) is applicable upon conversion of CCDs into equity shares

- Recently, the Hon'ble Kolkata Tribunal in case of **Milk Mantra Dairy Private Limited (ITA No.413/Kol/2020)** held that provisions of section 56(2)(viib) of the Income-tax Act, 1961 shall be applicable upon conversion of Compulsory Convertible Debentures ('CCDs') into equity shares.

Brief facts of the case:

- Assessee company was a private limited company engaged in the manufacturing and selling of dairy product. The Assessee had issued CCDs during AY 2011-12 and 2012-13, which had been converted into equity shares during the year under consideration i.e., AY 2013-14 at the pre-determined price range. Accordingly, during AY 2013-14, the Assessee issued 13.40 lakh equity shares at the face value of Rs. 10 to various parties including Venture Capital Funds, Non-Residents and other angel investors at a premium of Rs.16.11 crores.
- The Tax officer disregarded the Assessee's DCF method of valuation and computed the FMV of shares at negative of Rs. 294 under Net Asset Value method and thereby added entire issue price of equity shares to the total income under section 56(2)(viib).
- On appeal, the first appellate authority granted partial relief to the Assessee holding that Rs. 9.24 crores received from 'non-residents' to be outside the purview of section 56(2)(viib). It further deleted addition of Rs. 1,34,06,290 pertaining to the amount received towards face value of shares holding that section 56(2)(viib) is applicable only on the share premium and not the face value of the shares.

Key observations of the Tribunal:

- On appeal by the Assessee, the Tribunal observed that section 56(2)(viib) contains the words "receives any consideration". The term "consideration" is a term of wider import when compared with the words "amounts" or "money". Thus, section 56(2)(viib) encompasses consideration in all forms and is not limited to only 'receipt of money'. Receipt of money is one of the several modes for having a consideration in a transaction.

Key observations of the Tribunal (...contd.):

- The Tribunal observed that the term 'consideration' can partake many forms viz. tangible or intangible, pecuniary or non-pecuniary, direct or indirect.
- The Tribunal enumerated an illustrative list of the “considerations” that the assessee ‘receives’ on the conversion of its CCDs into equity shares as below:
 - The debt obligation on the assessee to repay is extinguished;
 - The charge created on the assets/properties of the assessee to secure the debt obligation is released;
 - The cost of servicing the debt obligation by paying periodic interest is mitigated;
 - The capital based in the form of own fund gets widened to leverage on the capital/stock markets;
 - The debt-equity ratio becomes favorable to various stakeholders of the assessee making it more investor attractive/lucrative
 - The risk of getting into the claim of insolvency resolution from the debt creditors in case of default in servicing their debt obligation is mitigated
- In view of above, the Tribunal held that the Assessee is in receipt of consideration on conversion of CCDs into equity shares and hence the provisions of section 56(2)(viib) are applicable.
- In relation to the valuation of equity shares upon conversion, the Tribunal held that tax officer was not empowered to change the DCF method of valuation adopted by the assessee and choose NAV method for valuation of equity shares.
- The Tribunal remitted the issue of valuation of shares to the tax officer to verify the scientific basis of valuation and rationality of assumptions adopted and further directed the Assessee to provide MIS data and all the other details of various assumptions adopted to arrive at the valuation of equity shares issued.