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Share valuation report to be rejected if no scientific base was provided for Co's projection report

Summary – The Bangalore ITAT in a recent case of Innoviti Payment Solutions (P.) Ltd., (the Assessee) held that where assessee allotted shares to a company on premium and fair market value of shares was done by Chartered Accountant on basis of Direct Cash Flow (DCF) method only depending on information about future projections provided by management of assessee, since assessee could not conclusively establish that such projection/estimation done by its management was on a scientific basis, Assessing Officer was justified in rejecting valuation done by Chartered Accountant

Facts

- The assessee company issued 10,658 shares having face value of Rs. 10 per share at premium of Rs. 23,50 per share. The assessee furnished the copy of the certificate issued by a chartered accountant and said that same was the basis for valuing the shares. The valuation adopted by the assessee was as per Discount Cash Flow (DCF) method.
- The Assessing Officer had noted and reproduced the relevant portion of the certificate issued by the Chartered Accountant which said that the projections were as per the estimate of the management and the Chartered Accountant provided no assurance that this information or the assumptions on which this information was prepared by the management were accurate. The Assessing Officer had noted that the submission of the assessee did not bring out any scientific basis for arriving the projected figures and the valuation report of the CA was on the basis of the projected figures provided by the assessee. Thus, he worked out the value of each share by adopting the net asset value (NAV) method.
- On appeal, the Commissioner (Appeals) also upheld the order passed by the Assessing Officer.
- On the assessee's appeal to the Tribunal:

Held

- There is no dispute on this factual aspect that the certificate issued by the Chartered Accountant is on the basis of information about future projections provided by the management and it could not be conclusively established by the assessee that such projection/estimation by the management is on a scientific basis although an attempt was made in this regard.
- As per report of research committee of The Institute of Charted Accountants of India (ICAI), the first and most critical input of DCF model is the Cash Flow Projections. It is also noted in the same para of this report that the DCF value is as good as the assumptions used in developing the projections. It is also noted that these projections should reflect the best estimates of the management and take into account various macro and micro economic factors affecting the business. In the same para of this report, some important points to be kept in mind with regard to cash flow projections are also noted.

- If a reliable estimate cannot be made than the provision cannot be recognized. In the present case in connection with DCF, it is seen that estimate/projection of future cash flow has to be made and as per report of research committee of ICAI first and most critical input of DCF model is the cash flow projections. Hence, by the same analogy, it has to be seen and ensured that such projection is estimated with reasonable certainty and if it is not established by the assessee that this is a reliable estimate achievable with reasonable certainty, the same cannot be recognized and if the future cash flow cannot be recognized than the DCF method is not workable.
- As per rule 11UA(2), the assessee can opt for DCF method and if the assessee has so opted for DCF method, the Assessing Officer cannot discard the same and adopt other method *i.e*. NAV method of valuing shares.
- The Assessing Officer can scrutinize the valuation report and he can determine a fresh valuation either by himself or by calling a final determination from an independent valuer to confront the assessee. But the basis has to be DCF method and he cannot change the method of valuation which has been opted by the assessee. Hence, the order of Commissioner (Appeals) is set aside and the matter is restored to the Assessing Officer for a fresh decision. The Assessing Officer should scrutinize the valuation report and he should determine a fresh valuation either by himself or by calling a final determination from an independent valuer and confront the same to the assessee. But the basis has to be DCF method and he cannot change the method of valuation which has been opted by the assessee. As per report of research committee of (ICAI), most critical input of DCF model is Cash Flow Projection, hence, the assessee should be asked to establish that such projections by the assessee based on which, the valuation report is prepared by the Chartered Accountant is estimated with reasonable certainty by showing that this is a reliable estimate achievable with reasonable certainty on the basis of facts available on the date of valuation and actual result of future cannot be a basis of saying that the estimates of the management are not reasonable and reliable.
- In nutshell, conclusions are as that the Assessing Officer can scrutinize the valuation report and if the Assessing Officer is not satisfied with the explanation of the assessee, he has to record the reasons and basis for not accepting the valuation report submitted by the assessee and only thereafter, he can go for own valuation or to obtain the fresh valuation report from an independent valuer and confront the same to the assessee, but the basis has to be DCF method and he cannot change the method of valuation which has been opted by the assessee. For scrutinizing the valuation report, the facts and data available on the date of valuation only has to be considered and actual result of future cannot be a basis to decide about reliability of the projections and. The primary onus to prove the correctness of the valuation report is on the assessee as he has special knowledge and he is privy to the facts of the company and only he has opted for this method. Hence, he has to satisfy about the correctness of the projections, discounting factor and terminal value etc. with the help of empirical data or industry norm if any and/or scientific data, scientific method, scientific study and applicable guidelines regarding DCF method of valuation.