

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'G':NEW DELHI**

**BEFORE SHRI S. RIFAUR RAHMAN, ACCOUNTANT MEMBER
AND
SHRI VIMAL KUMAR, JUDICIAL MEMBER**

**ITA No.5718/Del./2025
(ASSESSMENT YEAR : 2021-22)**

OYO Hotels and Homes Private Limited, vs. DCIT, Circle 19 (1),
4th Floor, Spaze Palazo, New Delhi.
Sector 69,
Grugaon – 122 001 (Haryana).

(PAN:AANCA6342H)

**ITA No.7237/Del./2025
(ASSESSMENT YEAR : 2021-22)**

DCIT, Circle 19 (1), vs. OYO Hotels and Homes Private Limited,
New Delhi. 4th Floor, Spaze Palazo,
Sector 69,
Grugaon – 122 001 (Haryana).

(PAN: AANCA6342H)

AND

**SA No.222/Del/2026
(in ITA No.5718/Del./2025)
(ASSESSMENT YEAR : 2021-22)**

OYO Hotels and Homes Private Limited, vs. DCIT, Circle 19 (1),
4th Floor, Spaze Palazo, New Delhi.
Sector 69,
Grugaon – 122 001 (Haryana).

(PAN: AANCA6342H)

(APPELLANT)

(RESPONDENT)

ASSESSEE BY : Shri Ajay Vohra, Sr. Advocate
Shri Manuj Sabharwal, Advocate
Shri Devvrat Tiwari, Advocate
Shri Manish Kumar, Advocate
REVENUE BY : Shri Mahesh Kumar, CIT DR

Date of Hearing : 09.03.2026
Date of Order : 04.06.2026

ORDER

PER S. RIFAUR RAHMAN, AM :

1. These cross appeals are filed by the assessee and Revenue against the order passed by the Ld. Commissioner of Income-tax (Appeals/ National Faceless Appeal Centre (NFAC), Delhi (ld. CIT (A) for short) dated 10.09.2025 for Assessment Year 2021-22.
2. Since the issues are common and the appeals are connected, hence the same are heard together and being disposed off by this common order. First we take up assessee's appeal being ITA No.5718/Del/2025 wherein the assessee's has raised the following grounds of appeal :-

“1. The Hon'ble National Faceless Appeal Centre ['CIT (A)'] has erred on facts and in law by upholding the order passed by the National Faceless Assessment Centre ('Ld. AO') to the extent adjustments made therein and upheld/ confirmed by the Ld. CIT (A).

2. The Hon'ble CIT(A) has erred on facts and in law by confirming the addition made by the Ld. AO, on account of share premium amounting to INR 3885,51,75,255, received by the Appellant on issuance of Compulsory Convertible Preference Shares ('CCPS') to its holding company [Oravel Stays Limited ('OSL')], on the basis that such share premium is taxable as per section 56(2)(viib) of the Income tax Act, 1961 ('the Act').

2.1 The Hon'ble CIT(A) has erred on facts and in law by disregarding the Appellant's submission that the present facts which involve issuance of CCPS by the Appellant to its holding company i.e. OSL, do not attract the provisions of section 56(2)(viib) of the Act.

2.2 The Hon'ble CIT(A) has grossly erred on facts and in law by disregarding the Appellant's submission that the Fair Market Value ('FMV') of CCPS determined as per the Discounted Cash Flow ('OCF') method is in due compliance with the applicable provisions of Rule 11 UA(I)(c)(c) of the Income-tax Rules, 1962 ('IT Rules').

2.3 Without prejudice, the Hon'ble CIT(A) grossly erred in law by accepting the valuation method adopted by the Ld. AO i.e. Net Asset Value ('NAV') method specified under Rule 11 UA(2)(a) of the IT Rules, in complete and blatant disregard of the specific option provided to and exercised by the Appellant (under Rule 11UA(2) of the IT Rules) to apply OCF method for the purpose of its valuation.

3. That on the facts and circumstances of the case and in law, the Hon'ble CIT(A) erred in confirming the addition of INR 9,21,10,000 made by the Ld. AO on account of Management fees.

3.1 The Hon'ble CIT(A) has grossly erred on facts and in law by disregarding the Appellant's submission . that the said amount represents accounting adjustment entry made by the Appellant in its books of accounts which is not taxable in the hands of the Appellant.

4. That on the facts and circumstances of the case and in law, consequential interest under section 234A and 234B of the Act has been erroneously levied for the subject A Y.

The grounds of appeal above are without prejudice to each other.”

3. Ground No.1 is general in nature, hence not adjudicated. Grounds No.4 relates to interest u/s 234A and 234B is consequential in nature.
4. Now we take up Ground No.2 which relates to addition under section 56(2)(viib) of the Income-tax Act, 1961 (for short ‘ the Act’). The relevant facts are, assessee is primarily engaged in the business of marketing, managing and operating hotels, long-term and short term stay homes, guest hoses and other accommodation including ancillary services, providing an affordable and predictable stay experience to

customers. It is also engaged in providing technical know-how and training in the field of operations and management of hotels motels etc. and in marketing and managing hotels and other boarding and/or lodging services.

5. During assessment proceedings, the Assessing Officer observed that assessee has issued large number of shares to different persons. In this regard, assessee was asked to establish the identity of the investors and prove the genuineness of the transactions and furnish relevant evidence to prove the creditworthiness. In response, assessee submitted that it has entered into a scheme of arrangement with its parent company i.e. Oravel Stays Limited (OSL) where India hotel business was demerged from OSL India, the assessee company. The above-said scheme was approved by the NCLT, Gujarat Bench vide order dated 26.09.2019. As per the terms of the scheme, shareholders of OSL were allotted shares of OHHPL for every share held by them in OSL. Therefore, no consideration in cash towards share application was received by the assessee from the shareholders of OSL. Based on that, 1 : 1 share is issued. Further, under the scheme of amalgamation, assessee has made fresh issue of compulsory convertible preference shares to its parent company, OSL as under :-

| S.No. | Name applicant | Date of transaction | No. of shares allotted | Issue price | Issue value | Share premium per share | Share premium value | Total consideration |
|-------|----------------------|---------------------|------------------------|-------------|---------------|-------------------------|---------------------|---------------------|
| 1 | Oravel Stays Limited | Apr-20 | 990,540 | 10.00 | 9905400.00 | 2,316.00 | 2,294,090,640.00 | 2,303,996.040 |
| 2 | Oravel Stays Limited | Nov-20 | 16391,430 | 10.00 | 1639143000.00 | 2,140.50 | 35,085,855,915.00 | 36,724,998.915 |
| Total | | | 17,381,970 | | 1649048400.00 | | 37,379,946,555.00 | 39,028,994,955 |

6. The Assessing Officer observed that net worth of the company as on 31.03.2020 was negative to the extent of (-) Rs.366630.36 million and as on 31.03.2021 it disclosed at (-) Rs.3765.75 million. It was observed that the above result as on 31.03.2021 was after the infusion of large shares capital and share premium during the year under consideration. It was also observed that assessee was incurring consistent loss from 2018-19 to 2021-22. The details of which are given at page 10 of the assessment order. The Assessing Officer observed that considering the above result, the assessee does not command such prime share valuation, and it was premium claimed to be excessive, appeared to be too high. In order to justify such valuation of shares, the assessee also presented the valuation report obtained from two consultants for valuation of shares allotted in April 2020 by M/s. TIPSONS Consultancy Services P. Ltd. (a merchant banker) and for valuation of shares in November 2020, the report was obtained from Chartered Accountant (Registered Valuer). Accordingly, notice u/s 142(1) was issued to the assessee to furnish copy of financial statements as on 31.12.2019 and 30.06.2020, as supplied to the above

said two consultants for valuation of shares and other details as mentioned in the show-cause notice which was reproduced at page 10 to 15 of the assessment order. In short, the assessee has submitted that the assessee has issued shares to its parent company by adopting DCF Method to determine FMV of shares which is in compliance of section 56(2)(viib) read with Rule 11UA of the Income-tax Rules. The valuation report submitted by the independent experts is based on DCF Method which is an internationally accepted method of valuation and also as per the provisions of section 56(2)(viib) read with Rule 11UA. It also submitted the copy of management certified projections for the period and valuation of shares. After considering the detailed submissions of the assessee, the Assessing Officer found several discrepancies in the valuation report as compared to the actual results and also various discrepancies in the data supplied by the assessee. Based on the above observations, the Assessing Officer proceeded to make the addition of Rs.1,76,04,108 which was added back to the detailed income of the assessee with the following observations :-

“18. Based on various judicial precedents, therefore, it may be concluded that while the assessee has the right to choose DCF valuation, they should be able to substantiate it with reasonable data since the Assessing officer, does have the power to question the correctness and reliability of such valuation. Thus, the valuation adopted by the assessee is liable to be not accepted/rejected, not because of the choice of method but because the parameters adopted by the assessee company had not been verified and are unrealistically adopted with a motive to achieve a predetermined valuation of shares.

18.1 Attention is also invited to Explanation to sec. 56(2)(viib) of the Act which reads as under:

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 prescribed¹⁶; 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;*

18.2 In the instate case, the same scrupulously followed. The prescribed methods of valuation to determine the FMV of shares are the NAV method under rule 11UA(2)(a) and the DCF method under rule 11UA(2)(b) at the discretion of the assessee. However, whatever method followed by the assessee the value of the share determined by the assessee has to be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares. Over and above, as per Explanation (a) (ii) to section 56(2)(viib) the fair market value of share needed to be substantiated on the date of issue of shares by the assessee, which has not been done by the assessee, hence same is not accepted/has to be rejected.

18.3 In view of the elaborate discussions made herein above on factual as well as legal aspects of the case, the Valuation report issued by the merchant banker / registered Valuer dated 09.04.2020, 14.09.2020 and/or 21.09.2020 are considered to be erroneous/defective / not reliable and are thus not accepted/rejected. In the absence, of the complete details/management certified/Audited Balance Sheet(s) on the date of issuance of Shares i.e. in April-2020 & November-2020 and reliable projections/forecasting of the Revenue receipts for the future years, no DCF Valuation of the shares can be carried out by the undersigned. Even otherwise, it is proved that, if realistic projections were adopted by the assessee, the FMV of shares even if calculated using the DCF method would have rendered a negative value of the shares so issued, which comes in agreement with the FMV of shares, if determined under the NAV method. Under such circumstances, there is no option left, but to tax the total share premium aggregating Rs.3737,99,46,555/- (representing Excess Share Premium) under provisions of sec. 56(2)(viib) of the Act. The definition of 'income' under Section 2(24)(xvi) of the IT Act was amended with effect from April 01, 2013 to also include consideration received for the issue of shares exceeding the FMV as referred to in section 56(2)(viib). Thus, such share premium was true 'income' which could be taxed under Section 56 of the I.T. Act.

18.4 During the year ended 31.03.2022, the company has converted 1,63,91,430 nos. of 0.01% G Series CCPS having the face value of Rs. 100/- each into an equal number of equity shares having the face value of Rs. 10/- each and remaining Rs. 90/- for each share aggregating Rs. 147,52,28,700/- is

transferred to securities premium account. This proves the fact that the assessee company has while issuing the Preference shares, intentionally kept the face value for issuance of 'G Series' shares at Rs. 100/-, even though it was clear that the said CCPS will convert into shares and it will be at par, with the face value of Rs. 10/- only and the balance Amount of Rs. 90/- per shares will have to be credited to share premium account. This proves the fact that such a differential amount of Rs. 147,52,28,700/- has the character of 'Share Premium' collected on such CCPS issued, and represents the 'Excess Share Premium' received. Since this amount is included in the DCF valuation determining FMV of shares and is also included in consideration received for the issue of shares exceeding the FMV as referred to in section 56(2)(viib); it is thus added back to the total income of the assessee company under provisions of sec. 56(2)(viib) of the Act.

18.5 Note no. 50 to Auditor's remarks / Notes on accounts reads as - "*The Company has significant accumulated losses aggregating to INR 53,533.76 million (31 march 2020 : INR 46,888 million) as the year-end against share holder's fund of INR 49,768.01 million (31 March 2020: INR 10,257.64 million). The management is meeting short term funding requirements through operational inflows and fund support from the parent. Accordingly, management considered it appropriate to prepare these accounts on a going concern basis*". Such a note is just sufficient to prove that the company which is operating based upon the support from parent with the infusion of capital in form of equity cannot command the huge premium valuation of shares.

18.6 In toto, an amount of Rs3885,51,75,255/- (being Rs3737,99,46,555/- + Rs. 147,52,28,700/-) is added back to the total income of the assessee company under the head 'Income from other sources'.

Penalty Proceedings u/s. 270A of the Act is initiated for under reporting of its income which is a consequence of misreporting under provisions of sec. 270A(9) of the Act.

19. Before departing, the real motive to make this series of transactions and undertake such an elaborate plan by the assessee is required to be understood. Normally, the promoters are issued shares at a premium with the purpose of keeping share capital low, yet with a stronger capital base so that the breakup value and market value are high. This leads to the advantage of the low cost of servicing share capital and also improved prospects to issue shares at a premium in the future by way of the initial issue of offering by promoters. When shares are issued at a premium, the number of shares and authorized share capital increase lesser in comparison to capital raised by way of the issue of fresh shares to the public by way of IPOs, etc.

19.1 In the instant case, it can be seen that the parent company M/s. Oravel Stays P Ltd. has received international funding in excess of \$1.5 billion. Later, the assessee company being its subsidiary was demerged in Sept-2019, having certain businesses. In compliance with the order of NOLT, Ahmedabad different investors of the parent company received the shares on 1:1 basis in the proportion of their investment at book value, i.e. @Rs. 10/- each and/or

@Rs. 100/- each (as the case may be). Subsequently, the Parent company made huge investments aggregating Rs. 39,028,994,955/- being the Shares issued at a substantial premium of Rs. 2,316/- and Rs. 2,140/- over and above the issue price. This act has artificially inflated the share valuation of other investors including the earlier investment made by M/s. Oravel Stays P Ltd. The Notes to Balance Sheet also describes, how and when the CCPS issued can be converted into equity. One important point included in such note is that before filing of Red Herring prospectus and entering the Share market and making public issue, these CCPS are to be compulsorily converted into equity shares, which may generate huge profits to investors. It is further fortified by the fact that OYO had filed its draft red herring prospectus (DRHP) for its initial public offering of around Rs. 8,430 crore (USD 1.2 billion) with the market regulator in October'2021. This appears to be the whole gamut of issuing shares at very high premium by the assessee company, even though it has never disclosed operating profits since the start of the business. Accordingly, it is very unlikely that its shares command such a high premium.

20. The assessee company has while filing return of income has made deduction of Rs. 1,76,04,108/- twice in col. 3(c) and 3(cii) of Schedule BP representing 'Income from Other sources' and income being 'Other than Dividend Income'. In fact, the assessee company has included such income only once, by crediting the P&L account. Accordingly, the assessee should have reduced such component of income only once. This is corroborated by the fact that the assessee has added back this figure only once in 'Schedule OS' as 'Income from Other Sources'. It is evident from the following scanned copy of the ROI filed by the assessee company:

| Schedule BP | | | | | |
|---|---|-----|----------------------------|------|-------------|
| 1 | Profit before tax as per profit and loss account (item 53, 61(ii) and 62(b) of Part A-P&L) / (item 53 of Part A-P&L - Ind AS) (as applicable) | | | 1 | |
| 2a | Net profit or loss from speculative business included in 1 (enter -ve sign in case of loss) | 2a | | 0 | |
| 2b | Net profit or Loss from Specified Business u/s 35AD included in 1 (enter -ve sign in case of loss) | 2b | | 0 | |
| 3 | Income/ receipts credited to profit and loss account considered under other heads of income/chargeable u/s 115BBF/ chargeable u/s 115BGG | a | House property | 3a | 0 |
| | | b | Capital gains | 3b | 34,32,563 |
| | | c | Other sources | 3c | 1,76,04,108 |
| | | ci | Dividend Income | 3ci | 0 |
| | | cii | Other than Dividend Income | 3cii | 1,76,04,108 |
| | | d | u/s 115BBF | 3d | 0 |
| e | u/s 115BGG | 3e | 0 | | |
| Profit or loss included in 1 which is referred to | | | | | |

20.1 In view of the same, it is proven beyond doubt that the assessee has deliberately claimed a deduction of Rs. 1,76,04,108/- twice, although eligible for claim for such 'Income to be treated separately' only once. This carries an effect of increase in carry forward of losses. Accordingly, this amount of Rs. 1,76,04,108/- is added back to the total income."

7. Aggrieved with the above order, assessee preferred an appeal before NFAC, Delhi and filed detailed submissions. After considering the detailed submissions, Id. CIT (A) sustained the addition by observing as under :-

6.8.6 Finally, we come to the AO's examination of the financial performance, projections and economic factors used by the valuer(s) in the valuation reports. The AO has elaborately and comprehensively dealt with this issue from pages 51 to 74 of her order. For the sake of brevity, I will only reproduce or redact the main conclusions. At the outset, it may be made clear that valuation is a highly technical and specialised exercise involving not just accountancy but also ventures into the realm of macro and microeconomics. As such I have to go by the merits and force of the arguments that the AO has used in the assessment order. The following paragraphs are not a technical analysis of the valuation process. I have recounted below those conclusions of the AO which I find contain merits and force and which I find have not been forcefully and satisfactorily countered by the appellant.

6.8.6.1 AO has drawn attention to the fact that the assessee company has signed a Share subscription agreement with Investor Company - M/s. Oravel Stays P Ltd. dated 16.04.2020. Subsequently, the Board of the assessee company passed a resolution dated 20.04.2020 and accorded consent for the allotment of 9,90,540 nos. of Series C Compulsorily Convertible Cumulative shares to the allottee. And, on the very same day M/s. Oravel Stays P Ltd. was allotted these shares, upon receipt of the requisite amount. This proves the fact that the valuation should have been made considering the facts & figures reported in the last Balance Sheet dated 31.03.2020.

AO has further held that it is grossly misleading and incorrect on the part of the Merchant Banker/assessee Company that knowing the fact that the share subscription agreement was signed on 16.04.2020, they were not aware of the wider repercussions of COVID-19 on the hotel & tourism industry. Under such an event, the assessee company cannot and should not take shelter, that the Projections shared with Merchant Banker were for the pre-COVID period and in absence of the visibility of widespread repercussions of the COVID Pandemic.

The appellant's answer in this regard as drafted by the merchant banker was as follows:

In the present case, we understand from the Management of the Company that when the company provided the projections for the valuation exercise, as on December 31, 2019, they had no visibility of the widespread repercussions of the COVID-19 pandemic on the hospitality and tourism industry. Accordingly, the projections shared by the Management were pre COVID-19, in absence of the visibility of

the widespread repercussions of the COVID-19 pandemic.

As per the International Valuation Standards, the minimum explicit forecast period which should be sufficient for an asset to achieve a stabilised level of growth and profits should be considered, after which a terminal value can be used. Since, the Management provided the projections for normalized operations, without factoring in COVID -19 impact, the Company was expected to achieve stabilised of growth and profits till CY 2024. Accordingly, projections till CY 2024 were considered in compliance with the internationally acceptable approaches and methodologies, after which a terminal value had been computed.

In my opinion the AO is right in contending that this reply is grossly misleading and incorrect. When the world was witnessing one of the great cataclysmic events of recent times which caused a massive slowdown of all the economies and in fact led to almost complete meltdown of the hospitality and tourism sector around the world, the argument of the merchant banker is unacceptable. When the merchant banker was cognizant of the impact of Covid-19 at the time of valuation he ought to have factored this into his valuation. Not doing so leads to the suspicion regarding the integrity of the valuation process and points to the fact that valuation was carried out with certain pre-conceived inclinations.

6.8.6.2 The AO has made a strong case by factually discussing the impact of Covid -19 and the timeline of the lockdown.

AO has analysed the projected cash flows used in the valuation and lucidly shown that very aggressive growth projections were used. She has observed as follows:

“In the instant case, the assessee company/Valuer has adopted very aggressive growth rates of 41%, 60%, 60%), & 45% while computing FMV of shares as on 31.12.2019, and similarly, the growth rate of 77%, 36%, 24%), 23% & 19% was adopted while making computation of FMV of charges as on 30.06.2020. Such an exorbitant Growth rate in perpetuity is highly unlikely and such a performance trajectory is not sustainable. And this is just sufficient to prove the unrealistic assumptions/projections made by the Assessee/Merchant Banker”.

The appellant has not been able to defend such aggressive projections either during the assessment proceedings or during the appellate proceedings.

On this issue the following portion of the assessment order is edifying:

8.9 In a bid to justify the projections of growth rate the assessee company has submitted that the projections for the valuation report dated 31st December 19for the investment made inApril-20 of INR 2.304 million was considering an environment where the company was growing at an accelerated pace. The assessee asserted that the same is

evident from the actual financials of the company which demonstrates YoY net margin.

(Amount in INR Mn)

| Year ending | Net Margin (Revenue from operation less cost of sales) | Growth % |
|------------------------------|---|----------|
| 31 st March 2017 | 413.8 | |
| 31 st March 2018 | 987.5 | 138.6% |
| 31 st March 2019 | 3,358.2 | 240.1% |
| 31 st March 2020* | 22,850.2 | 580.4% |

'post considering the demerger impact between assessee company and its parent entity i.e Oravel Stays Limited. whereby hospitality business of parent entity was transferred in assessee company

8.10 Even this submission of the assessee intended to create a fallacy as instead of working growth in Revenue earned directly the assessee company has utilized the figures of Net margin' to compute growth rate However, the Forecasted data with reference to Revenue growth with other calculations is actually used in making DCF valuation. This contention of the assessee appears to hold true historically till the year ending 31.03 2019 The figures as of 31.02 2020 cannot be compared as the enhanced revenue includes revenue from the Parent company (after demerger). It is already discussed that growth cannot be achieved in perpetuity Additionally, the DCF method for computation of the FMV of shares does not take into account any historical data At the same time, it is equivalently true that the projections of revenue as taken in two different valuation reports vary wildly and is multiple high, in comparison to the figures actually disclosed by the assessee company in the Balance Sheet for the year ending 31.03.2020 and 31.03 2021.

There is merit in the AO's argument that such aggressive projections are based on false estimates of growth since "the figures of 31.02.2020 cannot be compared as the enhanced revenue includes revenue from the parent company (after demerger)."

6.8.6.2 AO has also rightly pointed out the fallacies of appellant's arguments in respect of exuberant and aggressive growth projections at multiple points. Some such fallacies are pointed out on pages 60 as follows:

- The assessee's contention of a fivefold increase in the number of employees and 253% increase in the number of Hotels under OYO brand does not justify the forecasted aggressive growth rate in

revenue. An increase the in a number of employees may contribute to increased productivity, but at the same time also increase the expenditure of the company. Similarly, an increase in the number of hotels under management does not always translate into a positive contribution to Revenue as it mainly depends upon the occupancy of the properties under management, the tourist cycle and other unknown factors.

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- The assessee contended that the management was also hopeful of a business turnaround once the pandemic impact subsides. Such an assumption is one-sided. The assessee failed to account for other unforeseen threats viz. reoccurrence of the pandemic. any other calamities etc., which are likely to impact revenues There is no guarantee that once the pandemic is over, everything in the world will go easy and business cycles may not face any adversities from rising inflation, looming threat of recession etc.

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6.8.6.3 The AO compared values under Net Asset Value (NAV) method as per Rule 11UA. Found huge gap between DCF valuation adopted by assessee and NAV-based value, concluding DCF was manipulated to inflate share premium. AO held issuance of CCPS is a form of equity and thus covered by section 56(2)(viib).

6.8.6.4 AO then follows up with her own technical analysis of the valuation process, what went wrong and finally his own conclusions regarding the true value of the shares.

6.8.7. After carefully going through the overall arguments of the AO, I find that the AO has successfully demonstrated the discrepancies and procedural mistakes in the valuation process and the AO's arguments in this regard are full of merit and extremely convincing and backed up by technically sound analysis.

In view of the forceful and convincing arguments I am inclined to uphold the conclusion reached by the AO regarding the correct value of the CCPSs issued by the appellant. The grounds of the appellant in this regard are accordingly rejected.”

8. Aggrieved with the above order, assessee is in appeal before us.

9. Ld. AR of the assessee submitted as under :-

“LEGAL SUBMISSIONS

ISSUE 1(a): SHARE PREMIUM RECEIVED ON ISSUE OF COMPULSORILY CONVERTIBLE PREFERENCE SHARES (‘CCPS’) TO

OSL TAXED AS 'INCOME FROM OTHER SOURCES' AS PER SECTION 56(2)(VIIB) OF THE ACT [EXCESS OF CONSIDERATION RECEIVED OVER ALLEGED FAIR MARKET VALUE ('FMV')]

Provisions of section 56(2)(viib) of the Act are not applicable to the present transaction

1. The provisions of section 56(2)(viib) of the Act created a legal fiction to deem capital receipt as income, were introduced as an **anti-abuse provision aimed at arresting circulation of unaccounted money**. It is submitted that these provisions cannot be extended beyond their desired purpose. The intent of introducing of section 56(2)(viib) of the Act can be referred from the Budget Speech of Finance Act, 2012 and CBDT Circular No 1 of 2011 (*refer Pages 1 to 4 of the Case law compilation*).
2. The addition in terms of taxing share premium received on issuance of CCPS by a subsidiary to its holding company, would lead to taxing of own money of shareholders without any corresponding benefit.
3. It is submitted that the same issue in **the assessee's own case for AY 2018-19** has been adjudicated by the Hon'ble ITAT Delhi in the assessee's favour (*refer Pages 121 to 126 of the Case law compilation*).
4. Non-applicability of section 56(2)(viib) of the Act on transaction of share issuance by subsidiary to its holding company has also been upheld by the Hon'ble Delhi High Court (*refer Pages 44 to 47 of the Case law compilation*) in the case of *FIS Payment Solutions and Services India Private Limited v. Union of India [W.P.(C) 10289/2024]*. It is to be noted that the department itself has agreed to the proposition that the provisions of section 56(2)(viib) are not applicable to the transaction between holding and subsidiary company.
5. It is submitted that this issue is no longer res-integra as it has been adjudicated by the Hon'ble ITAT Delhi in the following decisions (*refer Pages 44 to 69 of the Case law compilation*).
 - a) *DCIT v. Kissandhan Agri Financial Services (P.) Ltd. [2023] 150 taxmann.com 390*
 - b) *BLP Vayu (Projects-I) Pvt. Ltd. v. PCIT [2013] 151 taxmann.com 47*
 - c) *ACIT v. Dhruv Milkose Pvt. Ltd. I.T.A. No. 8431/DEL/2019*
 - d) *ITO v. K V Global Pvt. Ltd. [2024] 160 taxmann.com 234*
 - e) *Rugby Regency (P.) Ltd v. ACIT [2024] 160 taxmann.com 1056*
 - f) *ITO v. Solitaire BTN Solar (P.) Ltd. [2024] 164 taxmann.com 170*
6. The CIT(A) has sought to distinguish the above authorities only on the footing that OSL held 99.6% and not 100% of the assessee post demerger. It is submitted that this distinction brought out by the CIT(A) is specious and wholly insubstantial.
7. It is submitted that similar issue has already been decided favourably by the Hon'ble Delhi ITAT in the case of *ITO v. K V Global Pvt. Ltd. (Supra)*, which

deals with a case where the holding company was holding 51% shareholding in its subsidiary (*refer para 6 to 7 at pages 68 and 69 of the case law compilation*). The reasoning of the Ld. CIT(A) is clearly in teeth of the decision of the Hon'ble ITAT in this case.

8. Without prejudice, the assessee humbly submits that the marginal dilution of 0.4% in shareholding of OSL is only on account of share allotment pursuant to demerger scheme (as explained in para 2 above) whereby shares of the assessee were issued to the shareholders of OSL. Thus, admittedly, there is no fresh infusion of funds from any other third-party investors. Even otherwise, the decision in *K V Global Pvt Ltd.* shows that the principle is not confined to a case of absolute 100% shareholding.
9. The assessing officer/ Ld. DR had placed reliance on the decision of the Delhi Bench of the Tribunal in the case of *Agra Portfolio(P.) Ltd vs. ITO* wherein the Hon'ble Tribunal upholding the order passed by the assessing officer held that where the assessee was unable to justify the DCF valuation, the assessing officer was competent to adopt NAV method of valuation instead.
10. The CIT(A) noted that the order of the Hon'ble Tribunal was reversed by the Hon'ble Delhi High Court in the decision reported as *Agra Portfolio (P.) Ltd v. PCIT : (2024) 161 taxmann.com 303* and the matter remanded to the assessing officer for decision afresh in light of the directions issued by the Hon'ble Delhi High Court, as per the DCF method. It is submitted that:
 - this judgement does not in any manner, discuss / contradict the principle upheld in case of *FIS Payment Solutions (supra)* in terms of non-applicability of section 56(2)(viib) between holding and subsidiary company.
 - the transaction in *Agra Portfolio(P.) Ltd* was not between holding and subsidiary companies.
 - the transaction in question is for issuance of equity shares which is governed as per Rule 11UA(2)(b) of the Income-tax Rules, 1962 ('IT Rules') vis-à-vis CCPS issuance in assessee's case which is governed as per Rule 11UA(1)(c)(c).

Discounted Cash Flow ('DCF') valuation adopted by the assessee for issuance of CCPS is in accordance with Rule 11UA(1)(c)(c) of the IT Rules.

11. Rule 11UA(1)(c)(c) of the IT Rules, specifically provides that FMV of shares (other than equity shares of an unlisted company) shall be determined as the price which such shares would fetch in open market. This provision supports the DCF based valuation, being the internationally accepted valuation principle for valuation of such shares.
12. Furthermore, the downstream investment made by OSL, a foreign owned and controlled company ("FOCC") is in compliance with Foreign Exchange Management (Non-Debt Instruments) Rules, 2019. As per clause 23 of the above Rules, the investment by OSL, an FOCC, into the assessee company will be treated as "Downstream investment", which required the assessee to

comply with the entry route, sectoral caps, pricing guidelines and other attendant conditions as applicable for foreign investment.

Without prejudice, FMV of shares computed as per DCF method is fully compliant with Rule 11UA(2)(b) of IT Rules

13. Even assuming that CCPS issued are akin to equity shares, Rule 11UA(2) grants a specific option for valuation of unquoted equity shares. In the present case, the DCF method adopted by the assessee is in accordance with option expressly granted as per Rule 11UA(2) of the IT Rules. However, the Ld. AO has grossly erred in disregarding the same on the basis that the valuation report was not reliable and in concluding that NAV is the correct method to be applied.
14. It is a settled proposition that once the taxpayer has opted for DCF method, the learned AO does not have any authority to change the basis of valuation of shares to NAV. Reliance in this regard is placed on the decisions:
- a) *PCIT v. Cinestaan Entertainment (P.) Ltd. (2021) ITA 1007/2019 (Delhi High Court) – refer para 32 at page 102 of the Case law compilation)*
 - b) *b) Agra Portfolio (P.) Ltd v. PCIT (2024) 161 taxmann.com 303 - refer para 17 to 19 at page 77 of the Case law compilation)*
 - c) *Hon'ble Bombay High Court in the case of Vodafone M-Pesa Ltd. v. Pr. CIT (2018) 92 taxmann.com 73 -refer para 9 at page 84 of the Case law compilation*

Valuation report has been obtained by the assessee from a Category I Merchant Banker (being the valuation expert) in compliance with Rule 11UA of the IT Rules

15. The assessee has obtained valuation report from a SEBI Registered Category I Merchant Banker(**refer page 335 of the factual paper book in ITA No.: 5718/DEL/2025**). However, the Ld. AO has grossly erred in incorrectly rejecting the Valuation report and arbitrarily proceeded to make his own valuation. It is a well-settled principle that valuation report obtained from a prescribed expert, cannot be rejected. The said principle has been upheld by the *Hon'ble Delhi High Court in the case of PCIT v. Cinestaan Entertainment (P.) Ltd. (supra)-refer para 33 of page 103 of the case law compilation*. In *Miheer H. Mafatlal v. Mafatlal Industries Ltd* (AIR 1997 SC 506), the Hon'ble Supreme Court held as under:
- “It must at once be stated that valuation of shares is a technical and complex problem which can be appropriately left to the consideration of experts in the field of accountancy.”

In *G.L. Sultania and Anr. v. SEBI* (AIR 2007 SC 2172), it was held by Hon'ble Apex court that:

“valuation of shares is not only a question of fact, but also raised technical and complex issues which may be appropriately left to the wisdom of the experts, having regard to the many imponderables which enter the process of valuation of shares. If the valuer adopts the method of valuation prescribed, or

in the absence of any prescribed method, adopts any recognized method of valuation, his valuation cannot be assailed unless it is shown that the valuation was made on a fundamentally erroneous basis, or that a patent mistake had been committed, or the valuer adopted a demonstrably wrong approach or a fundamental error going to the root of the matter.”

16. In that view of the matter, the rejection of the reasoned and scientific valuation report by an expert by the assessing officer on his *ipsi dixit* is not justified.

Management projections used for the purpose of DCF valuation are valid and reasonable; and the learned AO has erred in rejecting the same, on the basis of comparison with the actual performance of the business.

17. The projections considered as part of the valuation for both the share issuances, were based on past growth and therefore the assumptions are duly/ reasonably estimated by the management (as a prudent businessman) considering the assessee's business model and its future potential(**refer Pages 429 of the factual paper book in ITA No.: 5718/ DEL/2025**).
18. The assessee duly factored in the impact of the Covid-19 in the valuation undertaken for share issue transaction undertaken in November 2020 (**refer Pages 418 of the factual paper book in ITA No.: 5718/ DEL/2025**).
19. In this context, reference may also be made to the book value and FMV of similarly placed start-up public companies and private companies where it may be observed that the FMV of the companies is significantly higher than the book value notwithstanding/ despite the fact that these companies are incurring losses/ marginally profitable(**refer page 528 and 529 of the factual paper book in ITA No.: 5718/ DEL/2025**).
20. The learned AO's approach in challenging the management projections by comparing the same with actual numbers, is grossly incorrect. The above principle has been upheld by *Hon'ble Delhi High Court in the case of PCIT v. Cinestaan Entertainment (P.) Ltd. (supra)* and the *Hon'ble Bombay High Court in the case of Securities & Exchange Board of India & Ors (2015) ABR 291*.
21. The assessing officer / CIT(A) have faulted the valuation on DCF basis on further ground that the same was not based on the balance sheet on the valuation date (i.e., issue of CCPS in April 2020 and November, 2020). Under the DCF method adopted by the expert valuer, the valuation arrived at for issue of CCPS in April 2020 and November 2020 was based on further projections. Unlike NAV method, the valuation in terms of DCF is not arrived at on the basis of the balance sheet on the relevant valuation date and, therefore, the allegation of the assessing officer / CIT(A) is completely unfounded. Accordingly, that could not be the basis to reject the DCF valuation submitted by the assessee, based on report of an expert valuer.

ISSUE 1(b) :SHARE PREMIUM ON CONVERSION OF 16,391,430 CCPS

22. During the year the assessee had converted 16,391,430 CCPS amounting to Rs.147,52,28,700. The said amount has been taxed under section 56(2)(viib) of the Act. For the above-stated reasons, the addition of Rs.147,52,28,700 on conversion of CCPS issued in earlier years into equity shares during the relevant previous year, invoking section 56(2)(viib) of the Act is wholly unjustified.
23. For the cumulative reasons as aforesaid, action of the assessing officer in bringing to tax an amount of Rs. 3885,51,75,255 as income under section 56(2)(viib) of the Act is contrary to the facts of the case and the legal position. The same, therefore, calls for being reversed and the aforesaid addition deleted.

10. On the other hand, Id. DR of the Revenue submitted as under :-

- Ground No.2 - Addition of Share Premium of INR 38,85,51,75,255 u/s 56(2)(viib) of the Income-tax Act, 1961.

The Department respectfully submits that the Hon'ble CIT(A) has rightly confirmed the addition made by the Assessing Officer (AO) on account of share premium received by the appellant on issuance of Compulsory Convertible Preference Shares (CCPS) to M/s Oravel Stays Limited (OSL). It is respectfully submitted that Section 56(2)(viib) of the Income-tax Act, 1961 clearly provides that where a company receives consideration for issuance of shares exceeding the Fair Market Value (FMV) of such shares, the excess amount shall be treated as income in the hands of the company. In the present case, the AO has meticulously analyzed the valuation report submitted by the appellant and found that the consideration received by the appellant far exceeded the FMV as determined independently. The addition, therefore, is in strict accordance with the provisions of law, and the CIT(A) has correctly upheld the AO's action.

- **Ground No. 2.1 - Applicability of S.56(2)(viib) to the issuance of CCPS to the holding Company.**

The Department submits that the contention of the appellant that issuance of CCPS to its holding company is not covered under section 56(2)(viib) is wholly misconceived. There is no exclusion in the Act that exempts inter-company transactions from the operation of section 56(2)(viib). The AO has correctly applied the statutory provisions to the facts of the case, and the CIT(A) rightly declined to accept the appellant's submission. The transaction cannot be viewed in isolation as a mere related-party transaction; the fundamental test remains whether the consideration received exceeds the FMV, which is precisely the case here.

Further, reliance is being placed upon finding of Ld. CIT(A) in **Para 6.7.6,**

[Pg. 174 Of Assessee's Paper Book], wherein Ld. CIT(A) held that in the present case, the appellant is only 99.6% subsidiary and not 100% subsidiary. Therefore, there is no merit in the ground raised by the Assessee.

- Ground No. 2.2 - AO's rejection of the appellant's Discounted Cash Flow (DCF) valuation.

The Department submits that the AO's rejection of the DCF valuation adopted by the appellant is legally and factually justified. The DCF valuation provided by the appellant was found to be based on multiple assumptions and projections that were overly aggressive and not supported by audited financials or contemporaneous data. The AO, after detailed scrutiny, identified that the projections failed to account for the COVID-19 pandemic and its material impact on the hospitality and tourism industry, which is the appellant's business domain. Further, the AO observed discrepancies in the balance sheets used for valuation and reliance on unaudited financial statements, contrary to Rule HUA(l)(c) of the Income-tax Rules. In such circumstances, the AO was fully entitled to examine and challenge the reasonableness of the DCF assumptions, and the CIT(A) correctly upheld this approach.

Further, the assessing officer has comprehensively analyzed with sound technical analysis the Discount Cash Flow (DCF) valuation process adopted by the Merchant Banker and has found several discrepancies and procedural mistakes as elaboratively mentioned in **assessment order Para No. 8.3 to 18.2, Pg.49 to 78** and consequently has correctly rejected the DCF valuation of CCPS submitted by the Assessee.

Some of the discrepancies and procedural mistakes pointed by the assessing officer in DCF valuation submitted by the Assessee are as under

—

- (i) **AO Para 8.3, Pg. 50:** The Valuer has only utilized the facts & figures as reported in the unaudited Balance Sheet prepared on 31.12.2019 and 30.06.2020, which is complete contravention to the provision to rule 11U(b).
- (ii) **AO Para 8.5, Pg. 51:** While making a valuation of FMV of shares as on 31.12.2019. the Valuer in its report dated 09.04.2020. has considered the forecast period of only five years i.e. up to Dec-24. Whereas in the Valuation report dated 19.09.2020, providing valuation as on 30.06.2022, the forecast period is taken at 6.5 years. There is no uniformity in the computation of FMV on both dates of Valuation.
- (iii) **AO Para 8.5, Pg. 54:** The Assessee as well as the merchant banker could not furnish any reasons as to why the aggressive revenue growth rate forecast/assumptions are taken into consideration when the Valuation was carried out after the onset of COVID pandemic in the month of April-2020 and the reasoning as to why the "Valuation Date' was considered to be 31.12.2019 (Pre-COVID) period, even though the share subscription agreement itself was signed in the month of April-20. This is just a deliberate attempt by the Assessee company in connivance with the merchant Banker to adopt an aggressive growth rate to artificially jack up the figure for FCF Le. the Future Cash Flow, which is very sensitive towards the DCF valuation of

the shares and then considers the 'Additional Risk premium' while computing the COE and ultimately arrive the figures of WACC, which affects the 'Discount Factor.

- (iv) **AO Para 8.13, Pg. 57:** The revenue forecast as utilized in DCF valuation report is many times more than the actual historical performance. Even after providing of opportunity for personal hearing via Video conference held on 22.12.2022 attended by the Global Head - Taxation, India Head-Taxation of Oyo group and a representative from E&Y, could not furnish any scientific process followed which lead to forecast such a huge Growth rate. If we consider Revenue from the Balance Sheet as on 31.03.2021 which stands at INR 8692.65 million it translates into USD 118.74 Million (taking 1 USD 73.2065 INR as of 31.03.2021). These figures are not at all comparable with the projections/forecasted figures used in Valuation reports and are prone to return exponential growth rate which in turn has rendered a very high DCF valuation to the FMV of share.
- (v) **Assessing Officer Para.8.16,Pg.59-61:**The assesses contention of a fivefold increase in the number of employees and 253% increase in the number of Hotels under OYO brand does not justify the forecasted aggressive growth rate in revenue. An increase the in a number of employees may contribute to increased productivity, but at the same time also increase the expenditure of the company. Similarly, an increase in the number of hotels under management does not always translate into a positive contribution to Revenue as it mainly depends upon the occupancy of the properties under management, the tourist cycle and other unknown factors.
The actual figures till the year ending 31.03.2022 are available, as the Assessee company has already filed the return of income till AY 2022-23. It is seen that the forecasted revenue and other figures exceed 500% & more, which is just sufficient to prove that the Assessee company has adopted a very aggressive revenue estimation.
- (vi) **AO Para 8.17, Pg. 62:** The Assessee has not been able to furnish the correct details that went into and formed the basis for the projections made by it. There is absolutely no correlation between the figures adopted by the Assessee in its projections and the actual figures reported. The very basis for the DCF valuation was itself not substantiated by the Assessee. The Assessee couldn't produce the evidence to substantiate the basis of projections in cash flow and neither could provide reasonable connectivity between those projections in cash flow with the reality evidenced by the material.
- (vii) **AO Para 9.2, Pg.64:** The projected figures of revenue as adopted by the Assessee/merchant banker are too much on the higher side which in turn computes the growth rate and directly affects the DCF valuation. Thus, these projections are unrealistic and not reliable.
- (viii) **AO Para 10, Pg. 64-66:** The formula adopted by the Merchant Banker in computing the 'Cost of Equity' is erroneous.
- (ix) **AO Para 10.3, Pg. 66:** The Assessee company has selectively used the data to calculate the average levered and unlevered beta of comparable companies. It is seen that the beta of unlisted companies in not readily available and the case cited being comparable are also not really comparable in terms of the scale of operations, a business segment in which they operate i.e. Budget/Semi luxury/luxury hotels, Owned/managed Hotel properties, Commission based system by online booking etc.

- (x) **AO Para 10.4, Pg. 67:** The merchant banker has wrongly considered the Market return of SENSEX since inception fact the market return has to be the prevailing market return rate for short period maximum for the year prior to the Year in which the valuation is made. The SENSEX has dropped from 30427 as on 31.03.2018 to 19091 as on 01.04.2020, which pegs the short-term market return on SENSEX at (-)37.25%. It becomes important to note that the Assessee-company has started reporting revenue earnings from the FY 2018-19, Accordingly, expecting the market rate of return at 14.98%/14:11% is quite unrealistic on the face of their performance for the initial two years of their business.
- (xi) **AO Para 10.5, Pg. 67:** Even the modified erroneous formula described in the valuation report as $R = R_i + R_m + B(R_m - R_i) + R_a$ is not religiously followed and the computation is really made as per the standard formula and the additional risk premium is added back as per the wish of the Merchant banker, without taking into account the additional factor of R_m .
- (xii) **AO Para 11.1, Pg.71:** The Assessee company has already filed a return of income till AY 2022-23 i.e. for the year ending 31.03.2022. A comparison of the projected figures for the 'Capital Expenditure' as adopted in DCF valuation with that being actually disclosed in the Balance Sheet shows that it has a large difference, which has an effect to increase the 'Future cash Flow'.
- (xiii) **AO Para 15.2, Pg.75:** In view of the long disclaimer appended by the merchant banker which clearly establishes that no independent inquiry is caused by the merchant banker to verify the truth or otherwise the figures furnished by the Assessee at least on a test basis. The merchant bankers solely relied upon an assumption without independent verification, the truthfulness accuracy, and completeness of the information and the financial data provided by the company. A perusal of this long disclaimer clearly shows that the merchant banker did not do anything reflecting their expertise, except merely applying the formula to the data provided by the Assessee.
- (xiv) **AO Para 18, Pg.78:** Based on various judicial precedents while the Assessee has the right to choose DCF valuation, they should be able to substantiate it with reasonable data since the Assessing officer does have the power to question the correctness and reliability of such valuation. The parameters adopted by the Assessee company had not been verified and are unrealistically adopted with a motive to achieve a predetermined valuation of shares.

The reliance is placed on Hon'ble jurisdictional Delhi High Court's judgment in the case of **Agra Portfolio (P.) Ltd. vs. Principal Commissioner of Income-tax**, reported in [2024] 161 taxmann.com 303 (Delhi) [Copy Attached] wherein Hon'ble High Court has upheld the rejection of DCF valuation submitted by the Assessee in case the assessing officer is not satisfied about the correctness of the same. The relevant observations of Hon'ble High Court in this regard are reproduced as under –

17. While it would be open for the AO, for reasons so recorded, to doubt or reject a valuation that may be submitted for its consideration, the statute clearly does not appear to empower it to independently evaluate the face value of the unquoted equity shares by adopting a valuation method other than the one chosen by the assessee. It is this aspect which was duly acknowledged by the Bombay High Court in

Vodafone. M-Pesa. Ltd. (supra).

18. We note that the view as taken by the Bombay High Court in the aforementioned judgment appears to have been consistently followed by Tribunals of different regions as would be evident from the discussion which ensues. We, in this regard, firstly take into consideration the judgment rendered by the Mumbai Bench of the ITAT in Dy. CIT v. Sodexo Facilities Management Services India (P.) Ltd. [IT Appeal No. 2945 (Mum.) of 2022, dated 25-5-2023] where it was held as under:-

”18. On the other hand, Ld. Counsel for the assessee submitted that the AO has not accepted the method of valuation which was furnished by the assessee. The valuer computed the FMV by averaging the valuation as per PECV method as well as net asset value method. He submitted that when the legislation has conferred an option on the assessee to choose a particular method of the valuation, the AO cannot find fault in the said recognized method and adopting the method of his own choice. In support of this, he relied on the decision of the Hon’ble Jurisdictional High Court in the case of Vodafone M-Pesa Ltd. v. PCIT [2018] 164 DTR 257(2018) 92 taxmann.com 73/256 Taxman 240 (Bombay) (HC). As far as the worth of food division is concerned, the Ld. Counsel for the assessee submitted that assessee has followed the method prescribed under section 50B(3) of the Act alongwith Explanation (2). He submitted that in the net worth computed by the assessee and in the AO, there is only one difference. It was submitted that the assessee following the Explanation-2 below section 50B(3) of the Act has adopted written down value of the block asset in case of the depreciable asset as per the proviso to section 43 of the Act, which the AO has omitted.

19. We have heard rival submissions on the issue in dispute and perused the material on record. We find that computation of LTCG on the transfer of undertaking as the slump sale consists of two components. First component is sale consideration and the second component is the net worth or cost of acquisition. When the net worth of division is subtracted from the sale consideration, which results into LTCG on the slump sale. In the case of the assessee, the AO has taken FMV at Rs. 7,20,32,509/- which was worked out by the valuer following the PECV method, whereas the assessee has followed average value of PECV method as well as NAV method to justify the sale consideration actually received. We are of the opinion that Id Assessing Officer has not carried out valuation by an independent valuer and merely chosen a part of the valuation report submitted by the assessee. Therefore, we restore back the issue to the AO for referring the matter to a valuation expert by way of the issue of commission and

thereafter, determining the FMV of the undertaking of the food division of the assessee."

19. Proceeding along similar lines, the Hyderabad Bench of the ITAT in *Jt. CIT(OSD) v. MLR. Auto Ltd.* [IT Appeal No. 115 (Hyd) of 2021, dated 28-12-2023] had held as follows:

"17.1. The conjoint reading of Section 56(2)(viib) and Rule HU and 11UA makes it abundantly clear that in case assessee exercised his option for determination of the fair market value of the shares and exercise then such decision of the assessee shall be final and binding on the assessing officer. The option was given by the Act to the assessee either to apply the DCF method or net asset valuation method, this option is not available to the assessing officer. Rule 11UA provides the method of determining the FMV of a property other than the immovable property. Rule 11UA(2) reproduced hereinabove provides the method of providing the FMV of unquoted shares to be determined at the option of the assessee. 17.2. Once the assessee applied particular method of valuation, (in the present case DCF method), then it is the duty of the Assessing Officer / Id.CIT(A) to scrutinize the valuation report within the four corners or parameters laid down while making the valuation report under DCF method only. It is not permissible for the Assessing Officer to reject the method opted by the assessee and apply a different method of valuation and the Assessing Officer can definitely reject the valuation report but not the method. In case, the AO rejected the valuation report, then the AO has to carry out a fresh valuation report by applying the same valuation method and determine the fair market value of the unquoted shares. 18 .Therefore, in our view, the Assessing Officer was incorrect in concluding that the DCF method is "quite unrealistic and inapplicable" to the terms of the Income Tax Act. On the contrary, the DCF method is quite applicable and was required to be applied by the Assessing Officer to determine the FMV of the unquoted shares....."

20. A more detailed discussion on the issue which confronts us in this appeal is found in the judgment rendered by the Mumbai Bench of the ITAT in *Dy. CIT v. Credtalpha Alternative Investment Advisors (P.) Ltd.* [2022] 134 taxmann.com 223/193 1TD 502/[2022] 941TR (Trib) 596 and the relevant parts whereof are reproduced hereunder:

"15. Thus, the fair market value of the share shall be higher of the value as determined in accordance with the provisions of rule 11 UA or any other method, which can be substantiated by the assessee before the Assessing Officer. For the purpose of determining "fair market value" of un quoted shares provisions of rule 11 UA (2) applies which gives an option to the assessee to either value the shares as per prescribed formula given in clause (a) or clause (b) which provides for the determination of the fair market value based on discounted cash flow method as valued by a merchant banker or a chartered accountant (till 24th of May 2018). In the present case the assessee has valued the

shares according to one of the "options" available to assessee by adopting discounted cash flow method. Therefore, such an option given to the assessee cannot be withdrawn or taken away by the learned Assessing Officer by adopting different method of valuation i.e., net asset value method. The method of valuation is always the option of the assessee. The learned Assessing Officer is authorised to examine whether assessee has adopted one of the available options properly or not. In the present case, the learned Assessing Officer has thrust upon the assessee, net asset value method rejecting discounted cash flow method for only reason that there is a deviation in the actual figures from the projected figures. It is an established fact that discounted cash flow method is always based on future projections adopting certain parameters such as expected generation of cash flow, the discounted rate of return and cost of capital. In hindsight, on availability of the actual figures, if the future projections are not met, it cannot be said that the projections were wrong. To prove that the projections were unreliable, the learned Assessing Officer must examine how the valuation has been done. In a case future cash flow projections do not meet the actual figures, rejection of discounted cash flow method is not proper. If projected future cash flow and actual result matches, such situation would always be rare. For projecting the future cash flow certain assumptions are required to be made. These need to be tested and then such assumptions become the base of estimation of such projected future cash flows. If there are no assumptions, there cannot be an estimate of future projected cash flows and then discounted cash flow method becomes redundant. For exercise of valuation, assumption made by the valuer and information available at the time of the valuation date are relevant. As the exercise of valuation must be viewed as on the date of the valuation looking forward and cannot be reviewed in retrospect. Further, the valuation is always made based on review of historical data and projected financial information provided by the management. Further report of expert will always include limitation and responsibilities but that does not make his report incorrect. Of course, if there are errors in the working of projected cash flow, estimating the projected revenue and projected expenditure as well as in adoption of cost of equity and discount factor, the learned Assessing Officer is within his right to correct it after questioning the same to the assessee. The learned Assessing Officer can also question the basic assumptions made by the valuer. If they are unreasonable or not based on historical data coupled with the management expectation, the learned Assessing Officer has every right to question it and adjust the valuation so derived at. However, if he does not find any error in those workings, he could not have rejected the same. Further the reason given by the learned Assessing Officer that the net asset value method and the discounted cash flow method for valuation of the shares of the company gives a wide variation between them, we do not find any reason to find fault with the assessee in such cases. Both these methods have different approaches and methodologies therefore there are bound to be differences, but it does not give any authority to the learned Assessing Officer to pick and

choose one of the method and make the addition. It is the assessee who has to exercise one of the options available under the provisions of the law for valuing the shares. The learned Assessing Officer needs to examine that method. Naturally, if the discounted cash flow method and net asset value method gives the same result, where would have been the need to prescribe the two methods in the law. In view of above facts, we do not find any infirmity in the order of the learned Commissioner of Income-tax (Appeals) in deleting the addition of Rs.69,000,000 made by the learned assessing officer u/s 56 (2) (viib) of the act. Accordingly, ground Nos. 3 and 4 of the appeal of the learned Assessing Officer are dismissed. "

21. We deem it apposite to lastly take note of the following pertinent observations as appearing in a decision rendered by the ITAT Bench at Bangalore in Taaq Music (P.) Ltd. v. ITO [2020} SCC OnLine ITAT 9482 :

"11. The law provides that, the fair market value may be determined with such method as may be prescribed or the fair market value can be determined to the satisfaction of the Assessing Officer. The provision provides an Assessee two choices of adopting either NAV method or DCF method. If the Assessee determines the fair market value in a method as prescribed the Assessing Officer does not have a choice to dispute the justification. The methods of valuation are prescribed in Rule 11 UA(2) of the Rules. The provisions of Rule 11 UA (2) (b) of the Rules provides that, the Assessee can adopt the fair market value as per the above two methods i.e., either DCF method or fair market value of the unquoted equity shares determined by a merchant banker. The choice of method is that of the Assessee. The Tribunal has followed the judgment of Hon'ble Bombay High Court rendered in the case of Vodafone M Pes a Ltd. v. Pro CIT (supra) and has taken the view that the AO can scrutinize the valuation report and he can determine a fresh valuation either by himself or by calling a 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. The decision of ITAT, Delhi in the case of Agro Portfolio Ltd. 171 ITD 74 has also been considered by the ITAT, Bangalore in the case of VBHC Value Homes Pvt. Ltd. (supra).

12. In view of the above legal position, we are of view that the issue with regard to valuation has to be decided afresh by the AO on the lines indicated in the decision of TTAT, Bangalore in the case of VBHC Value Homes Pvt. Ltd., v. ITO (supra) i.e., (i) the AO can scrutinize the valuation report and he can determine a fresh valuation either by himself or by calling a 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. (ii) 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. 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. The order of Id. CIT(A) is accordingly set aside and this issue is remanded to the AO for decision afresh, after due opportunity of hearing to the Assessee. ”

22. Accordingly, and for all the aforesaid reasons, we allow the instant appeal and set aside the order of the ITAT dated 16 May 2018. The Questions of Law as framed, namely, Question A and C are answered in the negative and in favor of the appellant assessee. In light of the answers rendered in respect of the aforesaid two questions, the additional questions which are framed would not merit an independent examination. The matter shall in consequence stand remitted to the AO which shall undertake an exercise of valuation afresh in accordance with the DCF method.

23. We also accord liberty to the AO to determine the FMV of the shares bearing in mind the DCF Method by having the same independently determined by a Valuer appointed for the aforesaid purpose. ”

In the aforesaid judgment, the Hon'ble High Court held that the valuation of shares under section 56(2)(viib) read with Rule 11UA of the Income-tax Rules, 1962, is essentially a question of fact. The Court further held that the Assessing Officer has jurisdiction to examine the valuation report and underlying assumptions, including financial projections, valuation date, and methodology adopted. The Hon'ble Court emphasized that where the valuation report adopted by the Assessee is found to suffer from material infirmities or non-compliance with the prescribed rules, the appropriate course is to remand the matter to the AO for fresh determination, rather than mechanically accepting or rejecting the valuation. In the present case, the Assessing Officer has recorded detailed findings highlighting substantive defects in the Assessee's DCF valuation, including reliance on unaudited financials, incorrect valuation date, unrealistic projections, and failure to account for material economic factors. The Assessing Officer after pointing out several discrepancies and procedural mistakes in the DCF Valuation submitted by the Assessee has correctly rejected the same. Further, these findings have been affirmed by the learned CIT(A) as part of a reasoned factual conclusion.”

11 In rejoinder, ld. AR of the assessee submitted as under :-

“REJOINDER TO THE NOTE GIVEN BY THE LD. DR IN HEARING ON MARCH 9, 2026 WITH REGARD TO SUBMISSIONS MADE UNDER THE HEAD “SOME OF THE DISCREPANCIES AND

PROCEDURAL MISTAKES POINTED BY THE ASSESSING OFFICER IN DCF VALUATION”

(rejoinder to other submissions of the Ld. DR are already coming in the main synopsis above)

Preliminary : At the outset, the Ld. DR’s entire challenge proceeds on an incorrect legal footing. The shares issued by the assessee during the year were **CCPS and not ordinary equity shares**, and the assessee specifically relied on **Rule 11UA(1)(c)(c)**, which permits valuation of unquoted shares/securities other than equity on the basis of the price they would fetch in the open market, supported by a merchant banker’s report.

Without prejudice, even assuming Rule 11UA(2) were attracted, once the assessee adopts the DCF method, the AO can scrutinize that valuation only within the DCF framework and cannot reject it on hindsight or for actuals or substitute any other method/assumptions of his own. Even the case law reproduced in the Department’s own written submission accepts the said proposition.

Para-wise rejoinder to the submissions of the Ld. DR made under the head “some of the discrepancies and procedural mistakes pointed by the assessing officer in DCF valuation” is as under:

- (i) The objection of the Ld. DR regarding reliance on unaudited balance sheets is misplaced because the valuation was for CCPS under Rule 11UA(1)(c)(c)/ 11UA(2)(b) and not a mechanical balance-sheet formula or exercise i.e., NAV method prescribed under Rule 11UA(2)(a).

It is submitted that since DCF is inherently a forward-looking method, there is no requirement or relevance for an audited or unaudited balance sheet as the enterprise value is computed / valuation of shares is done basis the projections of a future date. The submissions of the ld. DR contain the said inherent fallacy and does not factor in the relevancy of the balance sheet (audited or otherwise) for the purpose of DCF valuation. Even otherwise, the valuation was supported by a merchant banker’s report and registered valuer’s report and is in compliance with Rule 11UA.

- (ii) There is nothing impermissible in having a **different forecast horizon for different valuation dates** and the said comparison projected by the Ld. DR in its submission is entirely conjectural and without any basis. The reason is obvious as June 2020 valuation adopted a longer period because COVID had disrupted the business and the management considered that a longer explicit forecast period was needed for stabilization; the June 2020 projections were in fact materially lower and more conservative than the December 2019 projections.
- (iii) The allegation that the December 2019 valuation was a deliberate pre-COVID device is untenable. It is trite that a DCF based valuation is made on the basis of facts available on the valuation date, not by hindsight.

The assessee's case has been that the December 2019 projections were pre-COVID, while the June 2020 projections specifically factored COVID disruptions and reduced the estimates. The said facts are corroborated inter-alia by reduced estimations of cash flows, growth rate etc for June 2020 projections.

- (iv) A comparison with actuals, *especially* figures for FY 2021-22, is legally irrelevant. It is trite that the methodology based on DCF is inherently a forward-looking method and variance from actuals cannot by itself invalidate the valuation made basis the DCF method. The authorities (such as that of Hon'ble Delhi High Court and Hon'ble Tribunal relied upon in the paper book) make it clear that DCF method cannot be rejected merely because future projections did not match actual performance and it is now a settled jurisprudence.
- (v) The Ld. AO/DR rely upon or isolate only two drivers, namely employee count and hotel count, and ignore the broader commercial basis for projections such as change in enterprise value due to demerger-led business transfer, substantial capital raised at the parent level from internationally reputed and marquee investors and the value seen in the business of the assessee by those investors, downstream investment into the assessee, acquisitions and setting up of new verticals, and high growth potential of upscaling the platform through which the business of the assessee is run. Further, the projections of the assessee were not based on headcount alone as sought to be projected by the Ld. DR and the submissions or arguments of the Ld. DR ignores relevant considerations, which the valuer or merchant banker (being the subject matter experts) have taken into consideration or factored in for the purpose of valuing the business of the assessee.
- (vi) The assertions that no basis for projections was furnished or that the assessee has not been able to furnish correct details with regard to valuation / aspects of valuation are both factually incorrect. The AO himself issued a detailed notice on 12.12.2022 seeking computation of FMV, formulas, terminal value, discounting inputs, beta, capex, debt/cash and all variables, and the assessee furnished a detailed response together with the Excel workings and explanations by the merchant banker before the AO.
- (vii) It is humbly submitted that mere making of a sweeping observation that projections are "too high" is not a legal ground to discard the DCF methodology. It is submitted that projections must be judged from the perspective of the valuation date and commercial expectations then prevailing, not from the armchair or skepticism of the income-tax department. It is also a settled jurisprudence that the Revenue cannot substitute its own view of business prudence for that of management and an independent merchant banker/ registered valuer.

The Delhi ITAT in *Cinestaan Entertainment (P.) Ltd. v. ITO* (2019) 106 taxmann.com 300 (which was upheld by the jurisdictional high court as well), wherein it was held that the commercial expediency has to be seen from the perspective of the businessman. The Tribunal while relying on the Hon'ble

Apex Court rulings in the case of *SA Builders* 288 ITR 1 (SC) and *CIT v. Panipat Woollen and General Mills Company Ltd.*, 103 ITR 66 (SC) held that:

“Any businessman or entrepreneur, visualise the business based on certain future projection and undertakes all kind of risks. It is the risk factor alone which gives a higher return to a businessman and **the income tax department or revenue official cannot guide a businessman in which manner risk has to be undertaken. Such an approach of the revenue has been judicially frowned by the Hon'ble Apex Court on several occasions, for instance in the case of SA Builders (supra) and Panipat Woollen and General Mills Co. Ltd (supra). The Courts have held that Income Tax Department cannot sit in the armchair of businessman to decide what is profitable and how the business should be carried out. Commercial expediency has to be seen from the point of view of businessman.** Here in this case if the investment has made keeping assessee's own business objective of projection of films and media entertainment, then such commercial wisdom cannot be questioned.”

- (viii) The challenge to the cost of equity computation does not identify or lead to any statutory violation. Admittedly, the merchant banker clearly disclosed the inputs used for beta, risk-free rate, market return, market risk premium, additional risk premium and WACC in its documentation. It is submitted that, at best, the Ld. DR raises a disagreement with the judgment of subject matter expert, and could not point out a patent error or defect in the valuation methodology. Further, the submission of the Ld. DR is cryptic and laconic and does not assign any reason for the error.
- (ix) The objections of the Ld. DR with regard to beta/comparables is also devoid of any merit. Perfect comparability is not the standard in valuation; reasonable public market comparables are commonly used to derive the variables used in the valuation and then the same are applied to company's capital structure. The valuation reports, in a transparent manner, identified the comparable hotel/travel companies used for the said purpose.
- (x) The criticism of using long-term market return/SENSEX data is again only a disagreement on valuation technique. The merchant banker expressly used Indian market inputs and long-term market return assumptions for valuation purposes.

The Delhi ITAT in the case of *Cinestaan Entertainment (P.) Ltd. v. ITO* (2019) 106 taxmann.com 300 (subsequently upheld by this Hon'ble Court) held that

“if law provides the assessee to get the valuation done from a prescribed expert as per the prescribed method, then the same cannot be rejected because neither the Assessing Officer nor the assessee have been recognized as expert under the law.”

The Hon'ble Bombay High Court in *Cadbury India Ltd. [2014] 49 taxmann.com 52 (Bombay)*, held as under:

“7.1.10 Valuation is not an exact science. Far from it. It is always and only an

estimation, a best-judgment assessment. The fact that a particular estimation might not catch an objector's fancy is no ground to discredit it. All valuations proceed on assumptions. To dislodge a valuation, it must be shown that those assumptions are such as could never have been made, and that they are so patently erroneous that the end result itself could not but be wrong, unfair and unreasonable.....”

The Hon’ble Bombay High Court in the case of *SEBI & Ors (2015) ABR 291*. Relevant extracts are as below:

“48.6 Thirdly, it is a well settled position of law with regard to the valuation that valuation is not an exact science and can never be done with arithmetic precision. **The attempt on the part of SEBI to challenge the valuation which is by its very nature based on projections by applying what is essentially a hindsight view that the performance did not match the projection is unknown to the law on valuations.** Valuation being an exercise required to be conducted at a particular point of time has of necessity to be carried out on the basis of whatever information is available on the date of the valuation and a projection of future revenue that valuer may fairly make on the basis of such information.”

The Hon’ble Supreme Court in the case of *Miheer H. Mafatlal v. Mafatlal Industries Ltd*(AIR 1997 SC 506) held that “It must at once be stated that valuation of shares is a technical and complex problem which can be appropriately left to the consideration of experts in the field of accountancy.”

- (xi) The issue raised by the Ld. DR about additional risk premium does not show any illegality from the computation standpoint. It is trite that the DCF method necessarily involves professional judgment on discount rate and risk adjustments. Reliance has been placed upon the judgements referred to in the preceding paragraphs.
- (xii) The objection of the Ld. DR with regard to capital expenditure rests on the actuals and the submissions on the said issues have already been made in the preceding paras. To reiterate, a valuation cannot be invalidated merely because subsequent events took a different course from what management estimated on the valuation date. Reliance has been placed upon the judgements referred to in the preceding paragraphs.
- (xiii) Admittedly, during the course of assessment proceedings, the assessee specifically pointed out that scope limitation and disclaimer are standard and that the merchant banker also later during such proceedings itself furnished the detailed explanations before the Ld. AO. The law also recognizes that valuation is a technical exercise by a prescribed expert and the same cannot be rejected lightly absent a fundamental or palpable error. In view of the above, it is submitted that issue of disclaimer raised by the Ld. DR is overstated and pales into insignificance. Further, the standard scope limitations in a valuation report do not render it subject to challenge or reduce its credibility or efficacy.

- (xiv) the DCF valuation was substantiated through valuation reports, supporting computations, explanatory replies, and clarifications of merchant banker submitted during the course of assessment proceedings. There is no motive of the assessee to achieve pre-determined values as the valuation is duly supported by valuation reports by independent merchant banker and registered valuers and hence the argument raised by the Ld. DR is devoid of any merit.

Without prejudice and independently, the entire issued with regard to DCF / valuation is ultimately academic because the CCPS / shares were issued by the assessee to its holding company.

The Hon'ble Delhi ITAT in the assessee's own case held that section 56(2)(viib), being an anti-abuse deeming provision aimed at taxing unjustified premium/unaccounted money, should not be extended to intra-group holding-subsidiary capital infusions unless there are concerns of money laundering, which do not exist in the facts of the case and such objections have also not taken by the Department or not borne out from the record.”

12. Considered the rival submissions and material placed on record. From the above facts on record, we observe that the assessee had issued CCPS after the reorganization of the company and in order to issue the above CCPS, the assessee had obtained the valuation certificates from the two valuers, which justified the issue of shares at a premium. The contention of the revenue is that the assessee had obtained the share valuation on the basis of aggressive projections which does not justify the issue of shares at such premium, considering the consistent losses recorded at the time of issue of shares. Further they observed that the data for projection was supplied by the assessee even though there was no apt atmosphere to issue shares, particularly the shares were issued during the period of Covid pandemic. Basically, the AO noticed that the data for valuation was supplied by the assessee with the intention to value the shares at an

abnormal prices in order to manipulate the share prices to get the unfair introduction of capital, which contravenes the provisions of section 56(2)(viib) of the Act. Based on that Ld CIT(A) also sustained the additions by accepting the findings of AO on the issue of aggressive valuation of shares by adopting the data supplied by the assessee and found discrepancies in the data while compared with the projections and actual performance and also rejected on the ground aggressive profit projected/declared by the assessee, according to him the growth is not commensurate with the aggressive growth projected by the assessee

13. After considering submissions of both the parties, we observed that the shares were subscribed by the parent and existing shareholders and further after reorganization the shareholding pattern of the existing shareholders, which was reduced from 100% to 99.6% post-merger. Basically, the shares were subscribed by the existing as well as holding companies. The scheme was approved by the NCLT/authorities and the change in the shareholding is due to issue of proportionate shares to the existing shareholders of the demerged entity. After considering the decision of coordinate bench in the case of K V Global Pvt Ltd (supra) and findings of Ld CIT(A), in our view, the shares were issued to the existing shareholders and the shares issued to them adopting the price valued on the basis of fresh valuation, specifically for this purpose, cannot be treated as meant to issue shares to obtain or introduce

unaccounted money into the system. At the same time, the decision relied by the Ld DR of Agra Portfolio P Ltd (supra), the facts are distinguishable.

14. After careful reading of the section 56(2)(viib) of the Act and intention of the legislature, the provision was brought in to curb the circulation of unaccounted money and in the case on hand, the shares were issued to the existing shareholders and also it is fact on record that the company was running in the consistent losses and only way to address such financial situation and bring the existing company out of debt is to introduce fresh and additional capital. That is the reason the parent holding and existing shareholders saw the potential in the company to introduce the fresh capital, they projected the future growth and based on the above projection, the valuation was carried and value of shares were obtained from the RBI approved valuers. It is established and settled position of law that the tax authorities cannot review the valuation of shares which was done on the basis of rule 11UA of the Income Tax Rules. In our view, subsequently the tax authorities cannot change the valuation method adopted by the assessee. Therefore, the tax authorities have gone beyond their jurisdictions in reevaluation of value of each share even though the same was valued by the registered valuers or merchant banker. It is complex and technical and assessing authorities does not possess such expertise. The Hon'ble High courts had settled the above

propositions in the following cases:

- PCIT v. Cinestaan Entertainment (P.) Ltd
- Vodafone M-Pesa Ltd. v. Pr. CIT (2018) 92 taxmann.com 73
- G.L. Sultania and Anr. v. SEBI (AIR 2007 SC 2172).

15. Another important aspect in this case is, the investments were made by the foreign owned and controlled company after due compliance with FEMA regulations, the downstream investment enrooting the funds from foreign entity cannot categorized under the unaccounted money.
16. Another issue under consideration is the AO had also made addition on conversion of CCPS issued in earlier years into equity shares during the year under consideration, that too he had invoked the provisions of section 56(2)(viib) of the Act, which itself unjustified. He cannot invoke a provision which has no relevance to the present and impugned assessment year. Therefore, we are inclined to delete both additions proposed u/s 56(2)(viib) of the Act and accordingly, the grounds raised by the assessee are allowed.
17. With regard to Ground No.3 regarding management fees, the relevant facts are, during assessment proceedings, the AO observed that the assessee has provided business support services in the accounting, legal, human resources, revenue management function etc. to its associates outside India. The management fee represents the earnings from

abovesaid services. For the year under consideration, the total management fees disclosed by the assessee at Rs.57,39,60,000/-. The assessee was asked to submit month-wise details of the income so received. The AO observed that assessee has made an abrupt deduction of Rs.92.11 million in the month of March, 2021. A separate notice was issued to the assessee to explain why the above adjustment should not be disallowed. In response, assessee submitted as under :-

"-----The assessee company would like to submit that negative figure of INR 92.11 Mn is due to accounting adjustment undertaken in the month of March 2021 due to incorrect entry posted in the ledger during previous months. In this regard, it may be seen from the quarterly trend that the management fee for every quarter is approx. 150 Mn with 15% +- variance.

| Sl. No. | Month | Transaction during the month (INR in Mn) | Quarterly (INR in Mn) |
|---------|----------------|--|-----------------------|
| 1 | April 2020 | 51.30 | 177.10 |
| 2 | May 2020 | 72.73 | |
| 3 | June 2020 | 53.07 | |
| 4 | July 2020 | 36.95 | 133.64 |
| 5 | August 2020 | 34.65 | |
| 6 | September 2020 | 62.04 | 137.86 |
| 7 | October 2020 | 31.32 | |
| 8 | November 2020 | 62.37 | |
| 7 | December 2020 | 44.17 | |
| 10 | January 2021 | 107.28 | 125.36 |
| 11 | February 2021 | 110.19 | |
| 12 | March 2021 | -92.11 | |
| | Total | 573.96 | 573.96 |

Therefore, it is humbly submitted, no arbitrary disallowance should be made in this regard in view of the accounting adjustments in the books of account----."

18. After considering the above submissions, the AO was not convinced with the submissions that accounting adjustment entered due to incorrect entries posted in the previous months. He observed that assessee failed to provide any evidence in this regard. He further observed that even during video conferencing, the assessee remained silent on the above issue. He

observed that the assessee company has nothing to say on this particular issue and is not in possession of the relevant evidence as asked for by him. Accordingly, he made the adjustment of Rs.9.12 crores to the total income of the assessee.

19. Aggrieved with the above order, assessee preferred an appeal before the NFAC, Delhi and before Id. CIT (A), assessee has made similar submissions as made before the AO. After considering the above submissions, Id. CIT (A) sustained the additions made by the AO.
20. Aggrieved with the above order, assessee is in appeal before us.
21. At the time of hearing, Id. AR submitted as under :-

1. In the course of assessment proceeding, the Ld. AO had asked the assessee to furnish the details of management fee income. The assessee duly furnished the month wise details of management fee income credited to profit & loss account(*refer detailed submission at page 545 of the factual paperbook in ITA No.: 5718/ DEL/2025*). The same is tabulated below:

| S. No. | Month | Transaction amount (INR Cr) | Quarterly amount (INR Cr) |
|--------|----------------|--------------------------------|---------------------------------|
| 1 | April 2020 | 5.13 | 17.71 |
| 2 | May 2020 | 7.27 | |
| 3 | June 2020 | 5.30 | |
| 4 | July 2020 | 3.69 | 13.36 |
| 5 | August 2020 | 3.46 | |
| 6 | September 2020 | 6.20 | |
| 7 | October 2020 | 3.13 | 13.78 |
| 8 | November 2020 | 6.23 | |
| 7 | December 2020 | 4.41 | |
| 10 | January 2021 | 10.78 | 12.53 |
| 11 | February 2021 | 11.01 | |
| 12 | March 2021 | (9.21) | |
| | Total | 57.4 | 57.4 |

2. The Ld. AO in the assessment order has disallowed the negative entry appearing in the month of March 2021 amounting to INR 9.21 Cr, alleging that it represents incorrect entries/ accounting adjustment.
3. The assessee follows the accrual method of accounting basis which the income is booked monthly on accrual basis / estimate basis as per the accounting principles, which are necessarily subject to **year-end true-up**. In case of any shortfall/excess in accruals, the same is adjusted appropriately in the books of accounts.
4. The quarterly trend of the management fee income is approx. 15 Cr (with 15% +- variance) and in order to correct an inadvertent/ incorrect entry posted in the ledger during previous months, the assessee has recorded the negative entry.
5. The AO has isolated a reversal entry passed in March 2021 and treated the same as income without undertaking the necessary exercise of examining whether the annual management fee income disclosed by the assessee stood understated at all.
6. The amount of Rs. 9.21 crores does not represent real income since the same neither accrued nor was received by the assessee. The concept of accrual of income is explained by the Hon'ble Supreme Court in the case of **E.D. Sasoon & Co. Ltd. vs CIT : 26 ITR 27 (SC)** in the following terms:

“Income may accrue to an assessee without the actual receipt of the same. If the assessee acquires a right to receive the income, the income can be said to have accrued to him though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed to him by somebody. There must be as is otherwise expressed debitum in praesenti solvendum in futuro. Unless and until there is created in favour of the assessee a debt due by somebody it cannot be said that he has acquired a right to receive the income or that income has accrued to him.”
7. The same principle has been reiterated in the later decision reported as **CIT v. Excel Industries: 358 ITR 295(SC)** wherein the apex Court laid down three tests to determine as to when income can be said to have accrued: (a) whether the income accrued to the assessee is real or hypothetical; (b) whether there is a corresponding liability of the other party to pay the amount to the assessee; and, (c) **the probability or improbability of realization of the income by the assessee considered from a realistic and practical point of view**. The Court observed as under:

“14. First of all, it is now well settled that income tax cannot be

levied on hypothetical income. In *CIT v. Shoorji Vallabhdas and Co.* [*CIT v. Shoorji Vallabhdas and Co.*, (1962) 46 ITR 144 (SC)] it was held as follows: (ITR p. 148)

“... Income tax is a levy on income. No doubt, the Income Tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in bookkeeping, an entry is made about a ‘hypothetical income’, which does not materialise. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account.”

15. The above passage was cited with approval in *Morvi Industries Ltd. v. CIT* [*Morvi Industries Ltd. v. CIT*, (1972) 4 SCC 451 : 1974 SCC (Tax) 140: (1971) 82 ITR 835] in which this Court also considered the dictionary meaning of the word “accrue” and held that income can be said to accrue when it becomes due. It was then observed that: (SCC p. 454, para 11)

“11. ... the date of payment ... does not affect the accrual of income. The moment the income accrues, the assessee gets vested with the right to claim that amount even though it may not be immediately.”

16. This Court further held, and in our opinion more importantly, that income accrues when there “arises a corresponding liability of the other party from whom the income becomes due to pay that amount”.

17. It follows from these decisions that income accrues when it becomes due but it must also be accompanied by a corresponding liability of the other party to pay the amount. Only then can it be said that for the purposes of taxability that the income is not hypothetical and it has really accrued to the assessee.

18. Insofar as the present case is concerned, even if it is assumed that the assessee was entitled to the benefits under the advance licences as well as under the duty entitlement passbook, there was no corresponding liability on the Customs Authorities to pass on the benefit of duty-free imports to the assessee until the goods are actually imported and made

available for clearance. The benefits represent, at best, a hypothetical income which may or may not materialise and its money value is, therefore, not the income of the assessee.”

8. The Delhi High Court in the case of **Amar Nath Khandelwal vs CIT: 126 ITR 322 (Del HC)** held that mere raising of bills which is not acknowledged by the other party would not result in any accrual of income.
9. In that view of the matter, the unilateral raising of claim of management fee on the overseas affiliates amounting to Rs. 9.21 crores, which has neither been acknowledged nor paid by the such entities cannot said to have accrued to the assessee. The withdrawal of the said amount by passing necessary entries in the books of accounts, therefore, needs to be allowed deduction.
10. Furthermore, the Courts have in the following cases stressed upon the taxation of real income and not any artificial / hypothetical income. Kind attention, in this regard, is invited to the following decisions :
 - **CIT vs. Shoorji Vallabhdas & Co. [1962] 46 ITR 144 (SC)**
 - **UCO Bank v. CIT: 237 ITR 889 (SC)**
11. To reiterate, reversal of excess accrual cannot, by itself, become taxable income as what can only be taxed is the real income and not notional income. Having regard to the aforesaid legal position, as applicable to the facts of the present case, addition of Rs. 9.21 crores is unwarranted and unjustified and, therefore, calls for being deleted.”
22. On the other hand, ld. DR of the Revenue relied on the detailed findings at page 7 of the assessment order and submitted that assessee has not provided any evidence of reversal of such management fees before the lower authorities. Therefore, he relied on the findings of the lower authorities.
23. Considered the rival submissions and material placed on record. We observed that the assessee had received the management fees from the other group entities and has recorded the income monthwise. It was claimed that the same was recorded on the basis of actuals as well as on

the basis of estimates. At the end of the year, the same was evaluated and reversed the excess provisions made during the year. We noticed that the above submissions were made by the assessee without proper documents and evidence. It is required that the assessee should have explained to the tax authorities the basis of claiming the management fees from the group entities for the whole year and it will settle the issued once for all. It cannot merely submit vague submissions without their proper justification for reversal particularly at the year end. If the assessee reverses the adjustment immediately in the next month itself, the issue would have settled, the AO would have understood the basis. It is the assessee who had to explain the reversals particularly at the year end. Accordingly, in our considered view, the assessee should be given one more opportunity, hence the present issue is sent back to the AO to verify the same after giving proper opportunity of being heard. In the result, ground raised by the assessee is allowed for statistical purpose.

24. In the result, appeal filed by the assessee is partly allowed as indicated above.
25. Now we take up Revenue's appeal being ITA No.7237/Del/2025 wherein Revenue has raised following grounds :-

“1. Whether on the facts and in the circumstances of the case and in law the Ld. CIT(A) NFAC has erred in deleting the addition made by the Assessing Officer on account of payments made to M/s Mypreferred Transformation & Hospitality Pvt. Ltd. (M/s. MTH), which in substance,

represent reimbursements for capital expenditure incurred on behalf of the assessee, and not mere revenue expenditure.

2. Whether on the facts and in the circumstances of the case and in law the CIT(A),NFAC has erred in not appreciating the fact that the payments led to tangible improvements and enduring capital benefits in OYO- branded properties, which infers that the expenditure was capital and not revenue in nature.

3. Whether on the facts and in' the circumstances of the case and in law the CIT(A), NFAC has erred on facts and in law to apply the settled legal principle laid down by the Hon'ble Supreme Court in McDowell & Co. Ltd. V. CTO (154 ITR 148), which holds that colorable devices or arrangements intended to evade tax must be disregarded, and the substance of the transaction prevails over its form.”

26. The relevant facts are, during assessment proceedings, the AO observed that assessee has claimed to have paid interest of Rs.1,04,62,20,293/- (@ 16% p.a.) to M/s Mypreferred Transformation & Hospitality Pvt. Ltd.(MTH) (a Fellow subsidiary) which is covered under the provisions of section 40A(2)(b) of the Act. The AO observed that interest rate paid is far in excess of prevailing market rate of interest which stands at 9% during the year under consideration. Accordingly, a separate show-cause notice was issued to the assessee as to why excess interest paid to the expenditure of Rs.45,77,21,380/- (Rs.1,04,62,20,293/- minus Rs.58,84,98,913/-) u/s 40A(2)(b) of the Act.
27. In response, assessee submitted as under :-

“M/s. Mypreferred Transformation & Hospitality Private Limited was a joint venture between Oravel Stays Limited (parent company of the assessee) and SB Topaz (Cayman) Ltd ("Softbank"). The said JV was made for the purpose of providing transformation and related advisory services including incurring capital expenditure on the property to meet OYO standards. To provide standardized OYO experience to all customers across properties, Assessee and it's holding company i.e. Oravel Stays Limited entered into agreement with MTH for hotel transformation including capex spending. Copy of the MFA is

enclosed as per Annexure-11. The broad terms of the agreement are explained hereunder:

- Assessee to enter into marketing arrangement with the property owner, whereby services to customers shall be provided by the hotel owners and assessee to provide marketing services to hotel owners along with the platform for listing their properties and charges agreed percentage as revenue share for the same.
- MTH to perform transformation services on properties identified by assessee under the works contract issued by assessee MTH to deploy Capex in order to perform its transformation services
- To cause each Hotel, and its appurtenances and grounds to be maintained according to the highest standards applicable within the hotel industry, or as may be prescribed by OYO from time to time.
- As a part of the Transformation Tasks, to incur capital expenditure on designing, renovating and upgrading the look and feel of the Hotels through landscaping, standardisation and fitting of requisite general equipment such" as air conditioners, television sets, furniture, coffee machines, and tablets and security equipment such as CCTV, electronic cards, monitoring systems, etc.
- To incur expenses, as may be required from time to time, on major repairs and maintenance for the Hotels.

MTH as per the arrangement will make a return of 16% on the cost incurred which will be recovered through the assessee company as monthly EMI over the period of contract or 24 months whichever is less. The assessee company had payables outstanding to MTH under this framework agreements over which MTH is required to earn 16% margin which has been categorized as interest in the financial statements of the assessee company which is not in pursuance of loan transaction but payment under consideration is in pursuance of Master Framework Agreement (MFA) between the parties. Therefore, any comparison with Bank loan rate is not valid and unfitting. Thus, it is humbly submitted that while as per accounting, INR 1,046,220,293/- has been grouped under Finance Cost (note 26) as 'Interest on Others', however, the same is not in the nature of interest on loan.....”

28. The AO summarily noticed the submissions of the assessee that its holding company, OSL entered into an agreement with MTH for hotel transformation including capex spending. MTH is a joint venture between OSL and SB Topaz (Cayman) Limited (“Softbank). The above-

mentioned joint venture was made for the purpose of providing transformation and related advisory services incurring capital expenditure on the property to meet OYO standards. The AO observed that on verification of the Master Framework Agreement (MFA) dated 15.03.2019, it is found that the said agreement was executed between OSL and MTH. AO observed that the whole agreement does not find any mention of the name of the assessee as one of the parties/stakeholders. Later assessee entered into a scheme of amalgamation with its parent company, OSL where India Hotel business was demerged from OSL India, the assessee company. The above scheme was approved by NCLT, Gujarat Bench dated 26.09.2019. Therefore, the above said MFA stands transferred from name of OSL to OHHPL. Further he observed that assessee had admitted that it stands payable outstanding to MTH under framework agreement over which MTH is required to earn 16% margin which is categorized as interest on others in the financial statements of the assessee, however it is not in the nature of interest on the loan. He further observed that it is immaterial, as to under which obligation, assessee is making the payment, but the true character of the transaction is what matters. The assessee considers itself to be a payment in the nature of interest, the same is necessarily required to be compared with the normal prevailing bank rate of interest. Hence, the AO proceeded to treat the same as interest expenditure and found that assessee had not

deducted TDS. Therefore, provisions of section 40(a)(ia) are violated. Based on the certificate from the Chartered Accountant that MTH has also recognized abovesaid receipt in the form of interest income. The AO observed that assessee has paid interest @ 16% to MTH which is Fellow Subsidiary which is covered under the provisions of section 40A(2)(b) of the Act. The same is in excess of normal rate charged by the bank for the year under consideration stands at 9%. Accordingly, he disallowed the difference as excessive expenditure claimed by the assessee. Accordingly, he proceeded to disallow the amount of Rs.104,62,20,293/-.

29. Aggrieved with the above order, assessee preferred an appeal before the NFAC, Delhi and submitted the detailed submissions. For the sake of brevity, it is reproduced below :-

- MTH was a joint venture between OSL and SB Topaz (Cayman) Ltd ('Softbank'). The said JV was made for the purpose of providing transformation and related advisory services including incurring capital expenditure on the property to meet OYO standards. In order to provide standardized OYO experience to all customers across properties, an agreement was entered into with MTH for hotel transformation (including the scope/responsibility in terms of incurring capital expenditure on the properties). A copy of the Master Framework Agreement ('MFA') dated 15 March 2019 entered into between OSL (which included its affiliates) and MTH is enclosed as per Annexure 12. The relevant terms of the MFA are clarified hereunder:

| <i>MFA Clause reference</i> | <i>Relevant provision of the MFA</i> |
|------------------------------------|---|
| 2.1 | <i>With an aim to facilitate the business activities and operations of each other, the Parties wish to collaborate and extend necessary support to each other in accordance with the terms and conditions set out in this Agreement</i> |
| 2.2 | <i>The Parties have mutually agreed to provide their respective Services in respect of Hotels in accordance with two business</i> |

| | |
|---|---|
| | <i>models namely, the 'Franchise Business Model' and the 'Operated Business Model'</i> |
| 1.1.28 | <i>"Services" shall mean: (i) with respect to the OYO Affiliate, the OYO Management Services, (ii) with respect to OYO, the OYO Marketing Services, and (Hi) with respect to MTH, the MTH Services;</i> |
| 1.1.18 | <i>"MTH Services" means the services that are required to be provided by MTH to the applicable Hotel, which shall consist of some or all of the services listed out in Schedule 2</i> |
| Schedule 2 to the MFA – Examples of MTH Services | <ul style="list-style-type: none"> ■ <i>To undertake and perform Transformation Tasks of each Hotel with the help of the relevant applications/ software.</i> ■ <i>To undertake and perform the Transformation Tasks as may be required by the relevant Hotel on a case to case basis.</i> ■ <i>To undertake and perform major maintenance and repair works at each Hotel, which are not in the ordinary course of day-to-day operations and management of such Hotel. These repair and maintenance works shall ordinarily be the responsibility of that Hotel's owner, failing which, MTH will undertake and perform these tasks subject to reimbursement from the Hotel's owner in accordance with the terms of the relevant Management Agreement. The service level standards for the performance of these repair and maintenance works by MTH will be mutually agreed between the Parties and the relevant Hotel's owner on a case by case basis.</i> ■ <i>To cause each Hotel, and its appurtenances and grounds to be maintained according to the highest standards applicable within the hotel industry, or as may be prescribed by OYO from time to time.</i> ■ <i>As a part of the Transformation Tasks, to incur capital expenditure on designing, renovating and upgrading the look and feel of the Hotels through landscaping, standardisation and fitting of requisite general equipment such as air conditioners, television sets, furniture, coffee machines, and tablets and security equipment such as CCTV, electronic cards, monitoring systems, etc.</i> ■ <i>To incur expenses, as may be required from time to time, on major repairs and maintenance for the Hotels.</i> ■ <i>Selection and purchase of operating supplies and equipment.</i> ■ <i>To supervise and purchase or arrange for the purchase of all inventories, provisions and supplies required for the performance of the MTH Services through inter alia the OYO Bazaar application.</i> |
| 1.1.35 | <ul style="list-style-type: none"> ■ <i>"Transformation Tasks" shall mean the detailed list of renovation, repair, refurbishment works required to be carried out on the relevant Hotel in order to make such Hotel operational, as determined by the Parties in accordance with Clause 3.1;</i> |

- As may be evidenced from the terms of the MFA, the present arrangement involves rendering of transformation support by MTH to

OHHPL, in consideration whereof, OHHPL shall be paying assured return to MTH by way of 16% margin on the cost incurred.

- Based on the above, during the financial year relevant to subject AY, the Appellant has claimed deduction amounting to INR 104,62,20,293, in respect of subject business expenditure payable to MTH under the above referred MFA.

Our Submission

- **We wish to submit our arguments on merits of the case as under:**
A. Subject expenditure is revenue in nature, incurred in connection with the business of the Appellant and therefore, deductible in accordance with provisions of section 37 of the Act

■ We wish to place reliance on the relevant provisions of Section 37 of the Act, which provides that “(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 Appellant), 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".

■ In the facts of the present case, the subject expenditure (amounting to INR 104 crores) represents charges/ assured return payable by OHHPL to MTH under the MFA. Since the said expenditure has been incurred wholly and exclusively for the purpose of the Appellant’s business operations and represents revenue expenditure, it has been claimed as a deduction in accordance with the provisions of section 37 of the Act while computing the taxable income of the Appellant.

■ Disregarding the above fact-pattern, the learned AO has incorrectly concluded that the above expenses are in the nature of capital expenditure as they are paid to MTH in connection with the capital expenditure incurred on behalf of the Appellant. In this regard, it is submitted that this basis for the present addition has been adopted without any query or explanation being sought in the course of assessment proceedings/ SCN issued to the Appellant. **Therefore, no opportunity has been provided to the Appellant to provide its submissions in response to the above referred allegation.** Since this approach is not in accordance with the principles of natural justice, the present addition is bad in law and liable to be deleted

• Without prejudice to the above, the Appellant wishes to submit that the capital expenditure is incurred by MTH as part of its overall services required to be rendered under the MFA and the said capex has been capitalized in the books of MTH as per applicable accounting standards. The Appellant has paid MTH consideration by way of assured return as per the terms of the MFA (as summarised above). The Appellant has not received any fixed assets or any form of intangible rights from MTH which may have triggered the requirement to capitalize this expenditure in the books of accounts of the

Appellant.

- In this regard, reliance is placed on the decision of the Hon'ble Supreme Court in the case of **Empire Jute & Co Ltd vs CIT [124 ITR 1 (SC)]**, wherein the following tests were laid down to determine whether the expenditure is capital or revenue in nature:

“.....There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, none the less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test. **What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test.**

If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is, therefore, not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case...”

(Emphasis supplied)

- Applying the ratio of the said decision to the facts of the present case, it will kindly be appreciated that by incurring the said expenditure, the Appellant neither acquired any asset nor any advantage of enduring nature in the capital field, to be regarded as capital expenditure. It is therefore submitted that the expenditure incurred by the Appellant under the MFA (i.e., expenditure w.r.t MTH) is not in the nature of capital expenditure. In light of the above, we wish to humbly submit before your honor that the said expenses are deductible in accordance with section 37(1) of the Act, and the subject disallowance should therefore be deleted.

B. Subject expenditure should not be disallowed under provisions of section 40A(2)(b) of the Act

- We wish to place reliance on the relevant provisions of Section 40A(2) of the Act provides that ^u(a) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this subsection, and the Assessing Officer is of opinion that such **expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities** for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction.”

■ We wish to highlight that, in the impugned assessment order, without prejudice to the above allegations, the learned AO has alternately treated the subject expenditure as interest and proceeded to disallow the same on the alleged basis that such interest is in excess of the normal rate charged by banks (i.e., 9%). Accordingly, the excess of such expenditure (over the 9% rate) has been disallowed on the basis of section 40A(2)(b) of the Act.

■ In the present facts, while the subject expenditure has been categorized as interest in the financial statements of the Appellant company, it is submitted that the same is not in the nature of 'interest' since it has not been incurred in pursuance of any debt/ borrowing but a payment for services availed by the Appellant in pursuance of the MFA between the parties.

■ In this regard, it may be relevant to note that section 2(28A) of the Act defines interest to mean "interest payable in any manner in respect of **any moneys borrowed or debt incurred** (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised." Given that the present agreement involves availing of transformation services (as outlined above) and no form of debt or borrowing has been provided by MTH to OHHPL, the subject expenditure should not fall within the meaning of interest.

• It is further submitted, that as per settled principle of law, the accounting treatment of an item should not have an impact on the tax treatment of the same. Reliance in this regard is placed on the ruling of Hon'ble Supreme Court in the case of **Taparia Tools Ltd. v. JCIT (2015) 55 taxmann.com 361**, which upholds the principle that entries in the books of account are not determinative or conclusive and the matter shall be examined on the touchstone of provisions contained in the Act.

• Further to the above, the Appellant submits that the intent of the legislature for introducing provisions of section 40A(2) is in nature of anti-tax evasion measures. The same is also evident from CBDT Circular No. 6-P dated 6 July 1968 which explained the amendments made in the Finance Act, 1968. Relevant extract is reproduced below:

"74. It may be noted that the new provision is applicable to all categories of expenditure incurred in businesses and professions, including expenditure on purchase of raw materials, stores or goods, salaries to employees and also other expenditure on professional services, or by way of brokerage, commission, interest, etc. **Where payment for any expenditure is found to have been made to a relative or associate concern falling within the specified categories, it will be necessary for the Income-tax Officer to scrutinise the reasonableness of the expenditure with reference to the criteria mentioned in the section. The Income-tax Officer is expected to exercise his judgment in a reasonable and fair manner. It should be borne in mind that the provision is meant to check evasion of tax through excessive or unreasonable payments to relatives and associate concerns and should not be applied in a manner which will cause hardship in bona**

fide cases. ”

(Emphasis supplied)

- Reliance in this regard is also placed on the decision of Hon'ble Bombay High Court in the case of **CIT v. Indo Saudi Services (Travel) (P.) Ltd.** (2009) 310 ITR 306 wherein it was upheld that no disallowance is to be made u/s 40A(2) in respect of the payments made to the relatives and sister concerns where there is no attempt to evade tax. Relevant extract has been produced below:

“5. In view of the aforesaid admitted facts we are of the view that the Tribunal was correct in coming to the conclusion that the CIT(A) was wrong in disallowing half per cent commission paid to the sister concern of the assessee during the asst. yrs. 1991- 92 and 1992-93. **The learned advocate appearing for the appellant was also not in a position to point out how the assessee evaded payment of tax by alleged payment of higher commission to its sister concern since the sister concern was also paying tax at higher rate** and copies of the assessment orders of the sister concern were taken on record by the Tribunal. ”

- Further, reliance in this regard can also be placed on the following judicial precedents:
 - Voltamp Transformers P. Ltd. v. CIT (1981) (Gujrat HC) 129 ITR 102
 - Shar-Lee Filtorites Pvt. Ltd. v. ACIT (2008) (Delhi ITAT) TIOL-500-ITAT
 - DEL - M/s. Swadeshi Internationals v. ACIT (2010) (Bangalore ITAT) ITA 703/2009
 - CIT vs. Modi Xerox Limited (All) 344 ITR 411

In the present case, the expenditure incurred by the Appellant company (an entity that has tax losses) has been duly included in the taxable income of the service provider entity (i.e., MTH) and due taxes have been paid on the said amount of INR 104,62,20,293 by MTH (an entity that has profits/ taxable income and which has been paying taxes on its income, including this income from the Appellant). Therefore, it would be evident that in the present facts, there has been no such tax planning or avoidance which is a pre-requisite for applicability of section 40A(2)(b) of the Act. In view of the above, provisions of section 40A(2)(b) should not be invoked/ are not applicable in the facts of the present case.

- Without prejudice to the above, even with regard to the alleged treatment of the subject expenditure as interest, it is submitted that the learned AO has failed to provide any justification with respect to calculation of interest rate @ 9% in the present case. In order to make disallowance u/s 40A(2)(b), it is a pre-condition that the learned AO is first required to determine the fair market value of the transaction and then compare the same with actual value of transaction and basis such determination, the amount found to be excess or unreasonable is liable to be disallowed u/s 40A(2) of the Act.

- Further, the learned AO has not provided any justification to determine the fair value of interest rate by providing any comparable case and has considered the normal interest rate charged by bank @ 9% on ad-hoc and arbitrary basis which is against the judicial principles. The onus placed on the assessing officer in this regard clearly has not been discharged and hence the disallowance made invoking section 40A(2) of the Act has no legs to stand.
- In this regard, reliance is placed on the decision of the Hon'ble Mumbai bench of Tribunal in case of **Motilal Laxmichand Sanghavi v. ACIT** (2019) 109 taxmann.com 186 wherein the disallowance made by the assessing officer u/s 40A(2) was deleted as no comparable case was provided by the tax authorities to demonstrate that the payment made by the Appellant was excessive or unreasonable having regard to the fair market value.
- We wish to humbly submit that the Learned AO has erred in disallowing the payment made to MTHL for business purposed as revenue expenditure and holding the same as capital expenditure. The Learned AO has alternatively treated the same as interest expense and proposed disallowance u/s 40A(2) after comparing the payment with random benchmark interest rate which is grossly baseless and bad in law.”

30. After considering the above details, ld. CIT (A) allowed the grounds raised by the assessee by observing as under :-

6.10 Adjudication of ground no. 5

I have carefully perused the assessment order, the grounds of appeal and the submissions. The facts are that in relation to its Hotel business, the appellant needed to *provide standardized OYO experience to all customers across properties*. For this purpose certain transformation and related advisory services were required that also involved the incurring capital expenditure on those properties listed under OYO that did not meet OYO standards. For this purpose a company called Mypreferred Hospitality Services Pvt Ltd was created which is a JV between OSL, the parent company of the appellant and SB Topaz (Cayman) Ltd (Softbank). A master framework agreement was signed vide which MTH was to provide these transformation services including making capital expenditure on the hotels/properties listed under OYO brand. After rendering such services MTH was supposed to bill it the appellant on a cost plus mark-up basis. The AO has held the payments made by the appellant to M/s MTH as capital expenditure and therefore not allowable.

I find that as a result of the transformation services certain capital expenditure is made which results in renovation, addition of fixtures, capacity expansion, etc. in respect of properties enlisted under OYO brand of the appellant. These properties are not owned by appellant. The tangible changes in the form of

capital assets or the rights to enjoy them are not with the appellant but with the property owners. Although the benefit that accrues is long term and capital in nature, it accrues to the property owners. No capital asset is acquired by the appellant. The arrangement is akin to a job work that M/s MTH performs for the appellant and the appellant makes payment on previously agreed terms. What is provided to the appellant by M/s MTH is a service and not any capital asset. The expenditure made by the appellant is therefore, revenue in nature. The ground is allowed.

The AO, in the alternative, has contended that if the expense is held to be revenue in nature, then it attracts the provisions of section 40(A)(2). This section provides as follows:

(2)(a) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause(b) of this sub-section, and the Assessing Officer is of opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction

.....

*(b) The persons referred to in clause (a) are the following, namely
(iv) a company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member or any other company carrying on business or profession in which the first mentioned company has substantial interest.*

The appellant has classified this payment as interest in its P&L account. In the opinion of the AO, the rate of interest of 16% is excess and unreasonable. The AO has pegged the reasonable rate at 9% which is the normal rate charged by the banks. The difference in the amount computed at the two rates has therefore been disallowed by the AO. I am of the opinion that the character of an item of income or expense has to be decided on the basis of what it is in lieu of and not on the basis of nomenclature used. It is obvious that the payment is not in respect of servicing of any debt or repayment for any loan but it is quite simply a payment for the service rendered to the appellant by M/s MTH. It is clear that the nomenclature used by the appellant is incorrect but the appellant cannot be penalised for this mistake. Since the payment is not in the nature of interest, therefore, the basis of addition that an excess and unreasonable rate of interest has been paid out, does not survive. The addition is deleted and this ground of appeal is allowed.”

31. At the time of hearing, Id. DR of the Revenue brought to our notice page

62 of the paper book which is the marketing and operational consulting agreement and as per the transformation sheet, it has given the details of various modification required by the owner. This is between the owner and MTH. He brought to our notice detailed findings of AO and also brought to our notice page 73 of the impugned order and submitted that the findings of the Id. CIT (A) are completely departure from the detailed findings given by the AO. He objected to the findings of the Id. CIT (A) and submitted that the relief granted by the Id. CIT (A) is towards capital expenditure incurred by the joint venture and Ld CIT(A) had completely over-looked the fact that the assessee was giving return to MTH @ 16% which is much higher than the normal return in any business. Therefore, he heavily relied on the findings of the AO.

32. On the other hand, Id. AR of the assessee submitted as under :-

1. MTH was a joint venture between OSL and SB Topaz (Cayman) Ltd ('Softbank') which was made for the purpose of providing transformation and related advisory services including incurring capital expenditure on the hotel property to meet OYO standards. In order to provide standardized OYO experience to all customers across properties, an agreement was entered into with MTH for hotel transformation.
2. As per Schedule 2 of the Master Framework Agreement ("MFA") (pg 22 of the paper book in ITA No. 7237/Del/2025), MTH was to perform the following services:
 - “1. To undertake and perform Transformation Tasks of each Hotel with the help of the relevant applications/software.
 - 2 To undertake and perform the Transformation Tasks as may be required by the relevant Hotel on a case to case basis.
 - 3 To undertake and perform major maintenance and repair works at each Hotel, which are not in the ordinary course of day-to-day operations and

management of such Hotel. These repair and maintenance works shall ordinarily be the responsibility of that Hotel's owner, failing which, MTH will undertake and perform these tasks subject to reimbursement from the Hotel's owner in accordance with the terms of the relevant Management Agreement. The service level standards for the performance of these repair and maintenance works by MTH will be mutually agreed between the Parties and the relevant Hotel's owner on a case by case basis.

4. To cause each Hotel, and its appurtenances and grounds to be maintained according to the highest standards applicable within the hotel industry, or as may be prescribed by OYO from time to time.
5. As a part of the Transformation Tasks, to incur capital expenditure on designing, renovating and upgrading the look and feel of the Hotels through landscaping, standardisation and fitting of requisite general equipment such as air conditioners, television sets, furniture, coffee machines, and tablets and security equipment such as CCTV, electronic cards, monitoring systems, etc.
6. To incur expenses, as may be required from time to time, on major repairs and maintenance for the Hotels.
7. Selection and purchase of operating supplies and equipment.
8. To supervise and purchase or arrange for the purchase of all inventories, provisions and supplies required for the performance of the MTH Services through inter alia the OYO Bazaar application.”
3. For the aforesaid services, MTH was to be paid cost + 16% (as per clause 9.78(ii) of the Shareholders Agreement).
4. During the relevant previous year, the assessee had paid an amount of Rs. 104 crores to MTH for the aforesaid services which was claimed deduction as revenue expenditure. The assessing officer disallowed deduction therefor to the extent of Rs.45,77,21,380 (in excess of 9%) on the ground that such expenditure (debited under the head “interest” in the books of accounts) was excessive having regard to the legitimate needs of the business. Alternatively, the assessing officer held that the expenditure was capital in nature and, therefore, the entire expenditure was, in any case, disallowable.
5. The CIT(A) noted that under the arrangement between the assessee and MTH, MTH undertook to perform renovation / refurbishment of the properties to be listed on the OYO platform; such expenditure was incurred at the premises owned by the third parties. The CIT(A) held that the said amount paid by the assessee to MTH did not represent capital expenditure and that the expenditure incurred was for the purpose of the assessee’s business operations and allowable revenue expenditure.

6. The CIT(A) further held that the amount, though labeled as 'interest' in the books of accounts was in the nature of service charges and not interest paid on borrowed sums and hence provisions of section 40A(2) of the Act had no application. The CIT(A), accordingly, deleted the disallowance in toto.
 7. As rightly held by the CIT(A), the expenditure in question is for enabling carrying on of the business of the assessee more profitably and efficiently; the same does not result in any addition to the profit earning apparatus nor any enduring advantage in the capital field. The same, therefore, does not constitute capital expenditure in the hands of the assessee as held by the Hon'ble Supreme Court in the case of **Empire Jute Co. Ltd. v. CIT : [1980] 124 ITR 1** and the latest decision in the case of **Sharp Business System v. CIT in Civil Appeal Nos. 15048–15051 of 2017 (SC)**.
 8. Furthermore, as rightly observed by the CIT(A), the said payment is not in the nature of interest and, therefore, resort to section 40A(2) of the Act to disallow the payment in excess of 9% is not justified.
 9. The CIT(A) having correctly appreciated the facts of the case in light of the applicable legal position, the order of the CIT(A) needs to be upheld and the appeal of the Revenue be dismissed.
33. Considered the rival submissions and material placed on record. We observed that in relation to its Hotel business, the assessee needed to provide standardized OYO experience to all customers across properties. For this purpose, certain transformation and related advisory services were required that also involved incurring of capital expenditure on those properties listed under OYO that did not meet OYO standards. For this purpose, a company called Mypreferred Hospitality Services Pvt Ltd (MTH) was created which is a JV between OSL, the parent company of the assessee and SB Topaz (Cayman) Ltd (Softbank). A master framework agreement was signed as per which MTH was to provide these transformation services including making capital expenditure on the

hotels/properties listed under OYO brand.

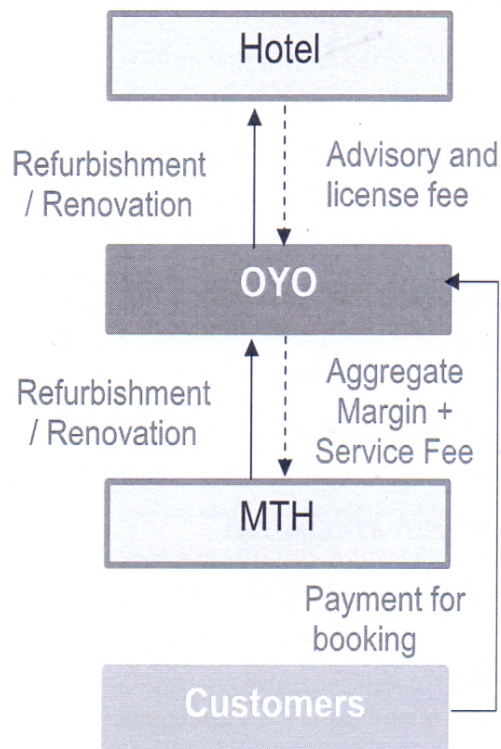
34. We perused the Master Framework Agreement dated 19th March 2019 and based on the above framework, the assessee entered into a tripartite agreement with MTH along with the hotel owners to work under common business venture and also within the framework of OYO business model. As per the above framework, there are two business models, these were offered to the hotel owners, i.e., Franchise Model and Operated business model.
- a. In the franchise model, the assessee itself enters into Hotel MOCA with the hotel owners and give separate indent to the MTH to execute the refurbishment/renovation to the respective hotel.
 - b. In the Operated business model, MTH will directly enter contract with the hotel owners to execute the refurbishment/renovation.
 - c. The task for the MTH would be to execute the transformation task of capital as well as repair expenses to address the design, renovation and upgradation of the look of the hotels through landscaping, standardization and fitting of requisite general equipments etc.,

- d. **The MTH will undertake and perform the above task subject to reimbursement from the hotel owners in accordance with the terms of the relevant management agreement.**
- e. **In return, the MTH will get assured return of service charges and guaranteed margin for the above services.**
- f. The assessee had structured the above transactions for franchise and operated business model as under:

SCHEDULE 1

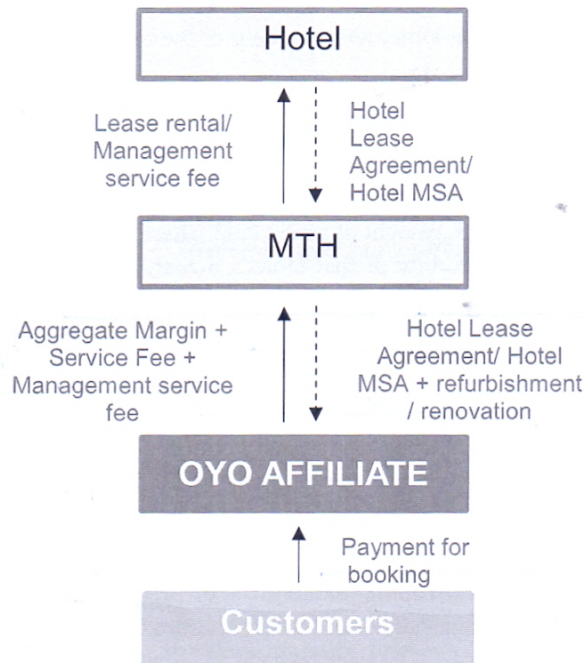
Business Models

FRANCHISE BUSINESS MODEL - FLOW OF FUNDS AND STRUCTURE



- Under the Franchise Business Model, OYO will enter into a Hotel MOCA with the Hotel for the property
- MTH would then invest in refurbishment/renovation of such Hotel, in return for which, OYO will pay the Aggregate Margin and the Service Fee to MTH
- Hence, OYO will be the only counterparty for MTH to receive the Aggregate Margin and the Service Fee

OPERATED BUSINESS MODEL – FLOW OF FUNDS AND STRUCTURE



- MTH would enter into either a Hotel Lease Agreement or a Hotel MSA with the Hotel for the property under the Operated Business Model, for which it would pay a lease rental/ revenue share to the Hotel
- MTH would then invest in the refurbishment / renovation of such property
- The OYO Affiliate will be a party to the Hotel MSA and provide OYO Management Services directly to the Hotel thereunder, or MTH will then enter into an OYO Affiliate Commercial Agreement with the OYO Affiliate, for a period of 4-5 years, in return of which, the Aggregate Margin and the Service Fee will be paid to MTH by OYO (either directly or through the OYO Affiliate), which shall include the lease rental. All details of the relevant OYO Affiliate will be intimated to and pre-agreed with MTH and SB in advance.
- The Aggregate Margin and Service Fee will be remitted to MTH by the OYO Affiliate, and OYO guarantees the payment of such Aggregate Margin and Service Fee, as provided under Clause 9.7 of the SHA.

g. From the above models, it is clear that the overall rent is paid by the customers and the cost of MTH services are already factored in the above models with the mutual acceptance of the assessee as well as the hotel owners. Since the above compensation to MTH is already factored into the room rent, therefore it is part and parcel of the standard cost for running of the hotel.

35. From the above business model and various MTH services as well as schedules to the Master Framework Agreement, it is clear that the capital investment on the refurbishment and improvement to the hotel is borne by the hotel owners or by the assessee depending upon the business model, the cost to carry out the above task is guaranteed to MTH in the form of service charges and margin. We noticed that the assessee had classified the above cost as financial cost under the head interest. However, Ld CIT(A) had appreciated the fact that there is no capital asset that is acquired or created and MTH has offered only services and it does not fall under the category of capital in nature. Further he observed that AO had applied the provisions of section 40(A)(2) and analyzed the claim of the assessee as an interest and held that the claim of the assessee is excessive. Ld CIT(A) further observed that the expenses had to be considered what it is rather than on the basis of nomenclature used. The expenses claimed are not for service of any debt or repayment for any loan but it is only payment for services rendered by MTH. After considering the detailed findings of Ld CIT(A), we do not see any reason to disturb the same. Therefore, the payment by the assessee to MTH towards the service and assured margin is only a revenue expenditure and the capital expenditures are incurred by the hotel owners and no enduring benefit for the assessee on the services provided by the MTH. Therefore, we are inclined to dismiss the grounds raised by the revenue.

36. The assessee has filed stay application no.222/Del/2026 for extension of the stay. As we have already decided the appeal in which stay was filed, the aforesaid stay application has now become infructuous and accordingly, the same is dismissed as infructuous.
37. In the result, appeal filed by the assessee is partly allowed as indicated above and appeal filed by the revenue is dismissed.

Order pronounced in the open court on this 4th day of June, 2026.

**Sd/-
(VIMAL KUMAR)
JUDICIAL MEMBER**

**sd/-
(S. RIFAUR RAHMAN)
ACCOUNTANT MEMBER**

**Dated : 04.06.2026
TS**

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

**ASSISTANT REGISTRAR
ITAT, NEW DELHI**