

आयकर अपीलीय अधिकरण, हैदराबाद पीठ
IN THE INCOME TAX APPELLATE TRIBUNAL
Hyderabad 'A' Bench, Hyderabad

BEFORE SHRI VIJAY PAL RAO, VICE PRESIDENT
AND
SHRI MADHUSUDAN SAWDIA, ACCOUNTANT MEMBER

आ.अपी.सं /ITA.Nos.2147, 2148 and 2149/Hyd/2025

Assessment Years 2016-2017, 2017-2018 and 2018-2019

DIABETOMICS Medical Private Limited, Hyderabad-500082. Telangana. PAN AAFCD3789H	vs.	The ACIT, Circle-8(1), Hyderabad. Telangana.
(Applicant)		(Respondent)
निर्धारित द्वारा/Assessee by :	CA MV Prasad And Sri KS Rajendra Kumar, IRS (Retired)	
राजस्व द्वारा/Revenue by :	MS U Mini Chandran, CIT-DR	
सुनवाई की तारीख/Date of hearing:	07.01.2026	
घोषणा की तारीख/Pronouncement:	11.02.2026	

आदेश/ORDER

PER VIJAY PAL RAO, VICE PRESIDENT :

These three appeals by the Assessee are directed against the three separate Orders all dated 18.11.2025 of the learned CIT(A)-National Faceless Appeal Centre [in short "NFAC], Delhi, for the assessment years 2016-2017, 2017-2018 and 2018-2019, respectively.

ITA.No.2147/Hyd./2025 – A.Y. 2016-2017 :

2. The assessee has raised the following grounds of appeal:

1. *“The order of the Ld. CIT(Appeals) is erroneous on the facts of the case and contrary to the provisions of law.*
2. *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) erred in sustaining the addition of Rs.9,56,51,200/- made u/s.56(2)(viib) of the Act in respect of Compulsorily Convertible Preference Shares (CCPS) issued at a premium by the appellant company*
3. *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) ought to have held that the AO has grossly erred in rejecting the fair market value (FMV) of unquoted equity share as determined by a Chartered Accountant in his valuation report as per the Discounted Free Cash Flow (DCF) method in accordance with Rule 11UA(2) of the Income Tax Rules, without proper and justifiable reasons.*
4. *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) ought to have appreciated that Rule 11UA(2) provides an option to the assessee to adopt either the NAV (Net Asset Value) or the DCF method for determining the FMV of the unquoted equity share and the FMV determined by the AO by applying a method which is not opted by the assessee is legally unsustainable since the AO has no power under the Act to change the method of valuation adopted by the assessee.*
5. *Without prejudice to the preceding ground, the Ld. CIT(Appeals) ought to have held that the adoption of face value of the equity*

share as the FMV of the share by the Assessing Officer is legally unsustainable as the said method is not one of the permitted methods under Rule 11UA(2),

- 6. On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) erred in concurring with the view of the Assessing Officer that the appellant company cannot be regarded as a Venture Capital Undertaking so as to be eligible for exemption from the application of the provisions of section 56(2)(viib) as per the first proviso thereunder on the ground that the appellant company cannot be considered to be "engaged in the business" of providing services, production or manufacture of article or things since admittedly it has not commenced its business operations.*
- 7. The Ld. CIT(A) ought to have appreciated that the expression "engaged in the business" cannot be equated with the expression "commencement of business", as it is a settled position in law that an assessee can be said to be engaged in business once it begins the setting up of the business.*
- 8. The Ld. CIT(A) ought to have held in the facts of the case that the appellant is engaged in business since it has begun to set up its business and it is eligible for exemption from the applicability of the provisions of section 56(2)(viib), being a venture capital undertaking, in respect of consideration received for issue of CCPS from a Venture capital company/fund, as per the first proviso thereunder.*
- 9. On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) erred in not holding that the provisions of section 56(2)(viib) are applicable to issuance of equity shares only and the said provisions are not applicable to issuance of Compulsorily Convertible Preference Shares (CCPS) by the appellant.*

10. *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) ought to have appreciated that the legislative intention behind introduction of section 56(2)(viib) is to prevent generation and circulation of unaccounted money and ought to have held that the facts of the appellant case do not warrant invoking of the said provisions.*
 11. *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) erred in sustaining the addition of interest on bank deposits of Rs.24,30,686/- under the head income from other sources. The Ld. CIT(A) ought to have held in the facts of the case that the said interest income requires to be capitalized, being incidental to the setting up of the manufacturing project and is not to be taxed as income from other sources.*
 12. *Any other legal grounds or factual grounds that may be urged at the time of hearing of the appeal.”*
3. Ground No.1 is general in nature and does not require any specific adjudication.
4. Ground Nos.2 to 10 are regarding the addition made by the Assessing Officer and confirmed by the learned CIT(A) u/sec.56(2)(viib) Income Tax Act [in short "the Act"], 1961. This issue is common for all three assessment years. For the purpose of recording the facts appeal for assessment year 2016-2017 is taken as “lead” case.

5. The assessee is a newly incorporated Company on 16.06.2015 and filed its return of income on 13.10.2016 for the assessment year 2016-2017 declaring loss of Rs.60,39,321/- under normal provisions of the Act and book loss of Rs.64,08,690/- under MAT provisions. The assessee company was incorporated with the primary business objective to manufacture and commercialize medical diagnostic products for early diagnosis of pre-eclampsia in pregnancy. The assessee also filed revised return of income on 30.10.2017 to the extent of declaring loss of Rs.60,37,461/- as against the loss declared in the original return of income of Rs.60,39,321/-. The returns of the assessee were selected for scrutiny under CASS. During the scrutiny assessment the Assessing Officer noted from the financial statements and other information filed by the assessee that the assessee received share premium of Rs.9,56,51,200/- against the issues of 1,34,730 shares. The shares were issued @ Rs.720/- per share at face value of Rs.10/- with a premium of Rs.710/- per share. The Assessing Officer issued show cause notice to the assessee regarding

the fair market value of the shares and the receipt of the premium as per the provisions of sec.56(2)(viib) of the Act. In response, the assessee filed share valuation report determining the fair market value of the shares on the basis of Discounted Free Cash Flow [in short "DCF"] method at Rs.720/- per share and thus, the assessee justified the issuance of the shares @ Rs.720/- per share of face value of Rs.10/- per share. The Assessing Officer did not accept the valuation of the share determined by the valuer and proceeded to adopt the fair market value of the shares based on Net Asset Value [in short "NAV"] method at Rs.10/- for the assessment year 2016-2017 and Rs.624.86 for the assessment year 2017-2018 and 2018-2019 and consequently, the Assessing Officer made an addition of Rs.9,56,51,200/- u/sec.56(2)(viib) of the Act for the assessment year 2016-2017.

6. The assessee challenged the action of the Assessing Officer before the learned CIT(A). The learned CIT(A) called for a remand report from the Assessing Officer. In the remand report, the Assessing Officer determined the

fair market value as per NAV method at Rs.624.86 and found an excess premium of Rs.95.14 per share and made the addition of excess premium of Rs.95.14 per share u/sec.56(2)(viib) of the Act. The learned CIT(A) did not accept the remand report and confirmed the addition made by the Assessing Officer and dismissed the appeals of the assessee on this issue for all three assessment years.

7. Before the Tribunal, the learned Authorised Representative of the Assessee has submitted that the assessee company was established for manufacturing patented medical diagnostic products of Diabetomics Inc, USA. The said US company was already in a commercial relationship with Becton Dickenson (BD), a global diagnostic major, for manufacture and supply of a point of care test for early diagnosis of Pre-eclampsia in pregnancy. This diagnostic product was to be exclusively manufactured for global supplies by the assessee company. The other diagnostic products are point of care tests for auto immune diabetes and gestational diabetes. These products are innovative and first of its kind products. He submitted that

the equity shares of the assessee company are held by Sri. K.I. Varaprasad Reddy (9000) shares, Sri Y.Sadasiva Rao (500 shares), Sri P. Vishnupriya Rao (500 shares) and M/s Ventureast Trust Company Pvt Ltd (10 shares). The assessee company has issued Compulsory Convertible Preference Shares [in short "CCPS"] of Rs.10 each during the previous years relevant to assessment years 2016-17 to 2018-19 to a Venture Capital Fund i.e., Ventureast Life Fund-III and to Sri.K.I. Varaprasad Reddy, the promotor. The learned Authorised Representative of the Assessee has further submitted that the CCPS are convertible into equity shares on or before the initial public offer in the ratio of 1:1 at a conversion price which is equal to the price at which the CCPS was subscribed to by the investors. He submitted that the CCPS were issued at Rs.720/- per share in all three assessment years under consideration. The issue price was determined on the basis of the Valuation Report prepared by a Chartered Accountant u/sec.11UA(2)(b) of the Income Tax Rules, 1962 by adopting DCF method. Further, the learned Authorised Representative of the Assessee has referred to the

provisions of sec.56(2)(viib) of the Act as well as Rule 11UA(2)(b) of I.T. Rules, 1962 and submitted that as per the provisions of the Act the assessee is given a choice to adopt one of the prescribed method of valuation for determining the fair market value of the shares as on the date of issue and therefore, the Assessing Officer cannot reject the method chosen by the assessee being DCF method for valuation of the fair market value of the shares. It is also not permissible for the Assessing Officer to substitute the method for determination of the fair market value. The Assessing Officer has adopted NAV for determination of the fair market value which is not permissible as per the provisions of the Act and Rules. Thus, the action of the Assessing Officer is contrary to the provisions of the Act u/sec.56(2)(viib) of the Act read with Rule 11UA(2)(b) of I.T. Rules, 1962. He has further submitted that the value determined by the Valuer based on the DCF is as per the available data and/or published data in the public domain and therefore, when the estimation under the DCF method is based on the data available in the public domain then, the valuation cannot be rejected merely on the ground

that the Valuer has not collected the information independently but determined the value as per the information provided by the assessee. He has further submitted that the legal fiction under the provisions of sec.56(2)(viib) of the Act cannot be applied in the case of the assessee in the absence of any allegation of generation and circulation of unaccounted money. The assessee has received the investment from the Venture Capital Funds and therefore, the assessee is a Venture Capital Enterprise as per the proviso to sec.56(2)(viib) of the Act and hence, the provisions of sec.56(2)(viib) of the Act are not applicable in the case of the assessee. The learned Authorised Representative of the Assessee submitted that the basis for the projections of revenue adopted in the valuation report is clearly evident from the annexure to the valuation report itself and the same was omitted to be taken into consideration by the Assessing Officer. It may be seen on perusal of the said annexure that the revenue projections have been made in a scientific manner by considering the population base of the concerned category of the patients for the relevant diagnostic

test, the size of the addressable market of such patients and the expected market penetration rate for the products of the appellant. The growth rate in the relevant population base from year to year has also been taken into account for making the said projections. He submitted that the projections have been made in this manner for each of the three types of diagnostic tests for which the assessee intended to manufacture diagnostic products. Hence, it is factually incorrect on the part of the Assessing Officer to state that the assessee failed to submit the basis for the projections considered for applying DCF method in the valuation report. The learned Authorised Representative of the Assessee further submitted that the assessee furnished detailed submissions to the Assessing Officer on this issue during the remand proceedings in response to specific query of the Assessing Officer requiring the assessee to provide the material which was used for making projections of revenue while applying the DCF method. It was explained therein that projections were made with the help of empirical data, industry norms and keeping in view the business plan,

patented technology of Diabetomics Inc USA which is to be made available to the assessee, innovative products, vast experience and reputation of the promoter Sri K.I. Varaprasad Reddy in developing vaccines and innovative products and growth potential. It was explained that the underlying projections were made on such reasonable assumptions as reflected in the Annexure to the valuation report. He submitted that the assessee furnished all the relevant material used for making the projections of the revenue while applying DCF method during the remand proceedings as manifest from the record placed at page nos.111 to 120 of the paper book. The learned Authorised Representative of the Assessee has further submitted that the learned CIT(A) expressed his disagreement with the remand report of the Assessing Officer by stating that the Assessing Officer failed to adduce any reconciliation of his findings in the remand report with categorical finding recorded by the Assessing Officer in the assessment order. Thus, the learned Authorised Representative of the Assessee has submitted that once the remand report was called for by the learned

CIT(A), the same cannot be rejected without finding a specific defect. The learned Authorised Representative of the Assessee has further submitted that the Assessing Officer has no authority to reject the valuation of the assessee based on the DCF method unless the valuation was made erroneously or by committing a mistake which goes to the root of the valuation process. The Assessing Officer has not brought any material or evidence on record to establish that the valuation of the assessee suffers from any fatal shortcomings. In support of his contention, he has relied upon the Judgment of the Hon'ble Delhi High Court in the case of **PCIT-2 vs. M/s. Cinestaan Entertainment Pvt. Ltd., [2021] 433 ITR 82 (Del.)** and submitted that the Hon'ble Delhi High Court has laid down a test for interfering with the findings of a valuer only when the assessee adopted a wrong approach or valuation was made on a wholly erroneous basis. He has also relied upon the Judgment of Hon'ble Madras High Court in the case of **CIT vs. VVA Hotels (P.) Ltd. vs. ITO [2020] 122 taxmann.com 106 (Madras)** and submitted that the Hon'ble High Court has held that unless the Assessing Officer is able

to bring out any evidence of abuse of the provisions with an intention to defraud the revenue, the option given to the assessee to adopt NAV or DCF method to arrive at the fair market value of the shares shall be held to be absolute. The learned Authorised Representative of the Assessee then relied upon the decision of ITAT, Delhi Benches, Delhi in the case of **Savegenis E-Marketing (P.) Ltd v. ITO [2025] 180 taxmann.com 13 (Delhi-Trib)** and submitted that the Tribunal has held that it is not legally permissible for the Assessing Officer to reject the valuation adopted by the assessee on the basis of the DCF method without pinpointing any specific inaccuracies or shortcomings in the DCF valuation report. The learned Authorised Representative of the Assessee has also relied upon the following decisions:

- a) PCCIT vs. A.H. Multisoft (P.) Ltd., [2025] 175 taxmann.com 46 (Del.) (HC);
- b) Autope Payment Solutions (P.) Ltd., [2025] 170 taxmann.com 333 (Del.-Tribunal).

7.1. Thus, the learned Authorised Representative of the Assessee has submitted that the DCF method is a recognized

method provided under the Rules and therefore, the valuation determined by the assessee through the Valuer based on the DCF method cannot be rejected without pointing out any defect such as a wholly erroneous basis or a mistake committed by the assessee which goes to the root of the valuation process. Thus, the learned Authorised Representative of the Assessee has submitted that as per Rule 11UA(2) of the I.T. Rules, 1962 the assessee has an option to determine the fair market value of the shares either as per NAV method or as per DCF method. Once the assessee has exercised such option to determine the fair market value as per DCF method, the Assessing Officer has no statutory power to disregard such option exercised by the assessee and determine the fair market value by using NAV method or any other method. In support of his contention, he has relied upon the following decisions:

- a) Agra Portfolio (P.) Ltd v. PCIT [2024] 161 taxmann.com 303 (Delhi) (HC);
- b) Akash Ceramics (P.) Ltd v. ITO [2024] 168 taxmann.com 407 (Gujarat) (HC);

- c) Pisces EServices (P.) Ltd [2024] 165 taxmann.com 840 (Bangalore-Tribu.);
- d) DCIT v. Home trail Buildtech (P.) Ltd [2023] 155 taxmann.com 578 (Delhi-Trib);

8. The next contention of the learned Authorised Representative of the Assessee is that as per Explanation-(b) to sec.56(2)(viib), the 'Venture Capital Undertaking' [in short "VCU"] shall have the meaning assigned to it in Clause-(c) of the Explanation to sec.10(23FB) of the Act and therefore, the meaning of 'VCU' is adopted as defined in clause-(n) of Regulation-2 of the Venture Capital Regulations. As per the Venture Capital Fund [in short "VCF"] Regulation as VCU being a domestic company whose shares are not listed at a Stock Exchange in India and which is engaged in the business of providing services, production or manufacturing of article or thing and does not include such activities or sectors which are specified in the negative list by the SEBI. He has relied upon the Judgment of Hon'ble Karnataka High Court in the case of **CIT vs. KBD Sugars and Distilleries Ltd., in ITA.No.773/2009** and submitted that the Hon'ble High Court has held that "commencement of the business"

may be different from the "engaged in the business" and a party engages itself in a particular business from the day it gets involved in setting up of the business. The Assessing Officer has given the findings in the remand report that the assessee is engaged in the business and is entitled to be treated as VCU. Thus, the learned Authorised Representative of the Assessee has submitted that the addition made by the Assessing Officer and confirmed by the learned CIT(A) are not sustainable in law and liable to be deleted.

9. On the other hand, the learned DR has submitted that the assessee is not a VCU as per the definition provided in Clause-(b) of Explanation to sec.56(2)(viib) r.w.s.10(23FB) of the Act. Therefore, the provisions of sec. 56(2)(viib) are applicable in the case of the assessee. He has referred to the annual report of the assessee and submitted that the assessee be expected to commence the manufacturing by 2018 and therefore, for the assessment years 2016-2017 to 2017-2018 there was no commencement of business of the assessee. The valuation determined by the Valuer is based on the details provided by the assessee and once there was no

commencement of business then, the question of any sales prior to 2018 does not arise. Hence, the valuation is based on non-existing details and facts. The learned DR has further submitted that these facts are not disputed by the assessee as also given in the remand report of the Assessing Officer that the assessee has not commenced its manufacturing activity as the facility itself was to commence from the year 2018. The Assessing Officer has given the reasons for rejection of the valuation in the assessment order at page-3 of the assessment order and therefore, if the valuation report is based on non-realistic data and information, the same cannot be accepted. The learned DR has further submitted that finally this project of the assessee failed and could not start its business, which corroborates and confirms the order of the Assessing Officer. He has relied upon the orders of the authorities below.

10. We have considered the rival submissions as well as relevant material on record. The assessee was a newly established company, manufacturing patented medical diagnostics of Diabetomics Inc. USA. Thus, the assessee was

a start-up and established for manufacturing innovative and special kinds of products for orally diagnosis of Pre-eclampsia in pregnancy. The existing shares were held by Sri K.I. Varaprasada Reddy, Sri Y. Sadasiva Rao and Sri P. Vishnupriya Rao and M/s. Ventureast Trust Company Pvt. Ltd., Thereafter, the assessee company issued CCPS. During the previous year's relevant to the assessment years 2016-2017 to 2018-2019 the assessee issued CCPS to a VCF namely Ventureast Life Fund-III and to Sri K.I. Vara Prasada Reddy the promoter. The details of the shares issued to the VCF and the promoter are as under:

A.Y.	Issued to Ventureast Life Fund III	Issued to K.I. Prasad Reddy	Total	Remarks
2016-17	93,055	41,665	1,34,720	Series-A CCPS
2017-18	1,152	71,909	73,061	48,611 Series - A CCPS and 24,450 Series - A1 CCPS
2018-19	---	22,500	22,500	Series A1 CCPS
Total	94,207	1,36,074	2,30,281	

10.1. The CCPS issued by the assessee are Compulsory Convertible into equity shares on or before the initial public offer in the ratio of 1:1 at a conversion price which is equivalent to the price on which CCPS was subscribed by the

investors. The assessee issued the shares at the price of Rs.720/- per share having face value of Rs.10/- per share at a premium of Rs.710/- per share. In support of this issue price the assessee submitted the valuation report by a Chartered Accountant under Rule-11UA(2)(b) of the I.T. Rules, 1962 based on DCF method. During the assessment proceedings, the Assessing Officer did not agree with the valuation of the assessee particularly, on the point that the Valuer has determined the valuation on the basis of information supplied by the assessee without conducting an independent enquiry and exercise. The Assessing Officer rejected the valuation of the assessee and the DCF method adopted by the assessee. The Assessing Officer proceeded to determine the fair market value of the shares by adopting the NAV method. Therefore, two issues arise from the assessment order as well as the impugned order of the learned CIT(A) are—

- (i) Whether the Assessing Officer has the jurisdiction to substitute the method of valuation as prescribed and chosen by the assessee as per Rule 11UA(2) of Income Tax Rules, 1962 ?

(ii) Whether the assessee falls in the exception provided in the proviso to Clause-(viib) of sub-sec. (2) of sec.56 of the Income Tax Act, 1962 being a Venture Capital Undertaking ?

11. As regards the first issue relating to the jurisdiction and power of the Assessing Officer to substitute the method of valuation as chosen by the assessee is concerned, the fair market value of the share shall be the value as determined in accordance with such method as may be prescribed or as the fair market value of the shares 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 asset whichever is higher. The fair market value of the shares to be determined as per the method prescribed in Explanation-2 Clause-(viib) of sub-sec.(2) of sec.56 read with Rule 11UA of I.T. Rules, 1962. For ready reference, the Explanation to Clause-(viib) and Rule-11UA(2)(a) and (b) are quoted as under:

“viiib) *where a company, not being a company in which the public are substantially interested, receives”, in any previous year, from any person, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares:*

Provided that this clause shall not apply where the consideration for issue of shares is received-

(i) by a venture capital undertaking from a venture capital company or a venture capital fund for a specified fund]; or

(ii) by a company from a class or classes of persons as may be notified" by the Central Government in this behalf:

Provided further that where the provisions of this clause have not been applied to a company on account of fulfilment of conditions specified in the notification issued under clause (ii) of the first proviso and such company fails to comply with any of those conditions, then, any consideration received for issue of share that exceeds the fair market value of such share shall be deemed to be the income of that company chargeable to income-tax for the previous year in which such failure has taken place and, it shall also be deemed that the company has under reported the said income in consequence of the misreporting referred to in sub-section (8) and sub-section (9) of section 270A for the said previous year.]

Provided also that the provisions of this clause shall not apply on or after the 1st day of April, 2025.]

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 prescribed; 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;

[aa] “specified fund” means a fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) for regulated under the “[Inter-national Financial Services Centre Authority (Fund Management) Regulations, 2022 made under the] International Financial Services Centres Authority Act, 2019 (50 of 2019)];

“Rule-11UA(2)”

[(2) Notwithstanding anything contained in sub-clause (b) of clause (c) of sub-rule (1), the fair market value of unquoted equity shares for the purposes of sub-clause (1) of clause (a) of Explanation to clause (viib) of sub-section (2) of section 56 shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner under clause (a) or clause (b), at the option of the assessee, namely:-

(a) the fair market value of unquoted equity shares = $\frac{(A-L)}{(PE)} \times (PV)$,

A = book value of the assets in the balance-sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

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

- (i) the paid-up capital in respect of equity shares;
- (ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
- (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;

- (iv) *any amount representing provision for taxation, other than amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;*
- (v) *any amount representing provisions made for meeting liabilities, other than ascertained liabilities;*
- (vi) *any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;*

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

PV = the paid up value of such equity shares; or

- (b) *the fair market value of the unquoted equity shares determined by a merchant banker or an accountant as per the Discounted Free Cash Flow method;*

[I.- Determination of value of assets and apportionment of income in certain cases.]”

12. As it is clear from the Explanation to sec.56(2)(viib) that the fair market value of shares shall be determined in accordance with such method as prescribed. Rule-11UA(2)(b) of I.T. Rules 1962 prescribes the method for fair market value of CCPS as in the case in hand. Thus, the rule provides the determination of the fair market value in accordance with the

methods enumerated in sub-clause (a) or (b) of sub-sec.(2) of Rule-11UA of I.T. Rules, 1962 at the option of the assessee. Thus, the option is given to the assessee to choose the method for determination of valuation, and no option or choice is given to the Assessing Officer to substitute or adopt any other method than the chosen by the assessee. Sec.56(2)(viib) read with Rule-11UA(2) makes it clear that the fair market value of the shares determined as per the prescribed method or as per the NAV whichever is higher shall be considered. There is no quarrel that the Assessing Officer has the power and jurisdiction to reject the valuation so determined by the assessee and proceed to determine the fair market value of the shares correctly if the valuation of the assessee is not found proper and correct. However, determining the fair market value by the Assessing Officer does not give him a choice to change method of valuation. In otherwords, the Assessing Officer can reject the valuation but has no jurisdiction to reject the method of valuation. The Hon'ble Madras High Court in the case of **CIT vs. VVA Hotels (P.) Ltd.** (supra) has held in Paras-8 to 14 as under:

“8. On going through the figures of excess projection of sales, as mentioned by the Assessing Officer in a tabulated form in paragraph 4.2 of the assessment order, we find that the excess projection for 2013-14 was 10%, for 2014-15-4%, for 2015-16-8% and for 2016-17-18%. Therefore, the finding recorded by the CIT(A) that difference was marginal is found to be correct, though it may be stated that the difference of 18% for assessment year 2016-17 may be little on the higher side, but still unless and until there was material available with the Assessing Officer to pin down the assessee on the ground of fraud or misuse of the provisions of law, the adoption of the DCF method cannot be held to be wholly illegal. Further, the CIT(A) rightly took note of the nature of business, which was done by the assessee company and the vagaries of business atmosphere in the country in general and in Chennai in particular. Thus, on facts, the CIT(A) found that the assessee company has not abused the privilege of choosing the DCF method for arriving at the value of the shares instead of NAV method.

9. The Revenue contended before the Tribunal that the CIT(A) ignored the huge variation in value of shares to the extent of ten times between value adopted by the assessee company as against its actual value of underlying assets, the CIT(A) erred in ignoring the finding of the Assessing Officer that there is no basis for the discount factor adopted by the assessee company as at 16%. The assessee contended before the Tribunal that they had adopted the DCF method as available under Rule IIIA of the Rules for arriving at the value of the shares allotted and the share premium received whereas, the Assessing Officer adopted the NAV method and re-valued the land owned by the assessee company for the purpose of determining the share value of the premium thereof.

10. It was submitted that when the assessee has adopted a particular method of valuation as provided under the Act and Rules and in the absence of any material that such method was adopted to defraud the Revenue, merely because the Assessing Officer is of the view that NAV method alone has to be adopted is not a ground to reject the DCF method. The Tribunal upon consideration of the facts pointed out that the assessee has adopted the method of valuation as stipulated under Rule 11UA of the Rules and this accepted method of valuation does provide for estimation. Noting that the Assessing Officer had discarded the DCF method adopted by the assessee on the ground that the actual revenue varied from the projected revenue for four years, the Tribunal rightly noted that the projected value is an estimate and the variation in the estimate is marginal. Therefore, the Tribunal came to the conclusion that there was no material to hold that the assessee's projected sales revenues are fabricated or manipulated.

11. Furthermore, it was pointed out that the Assessing Officer did not point out any flaw in the method of calculation of the value of shares by adopting the DCF method but, out rightly rejected the same, which should not have been done. The Revenue by relying upon the decision of the Division Bench of this Court in *CIT v. Vouni Estates (P) Ltd.* [2019] 107 taxmann.com 15/264 Taxman 310, submitted that the matter may be remanded to the Assessing Officer for fresh consideration to determine the fair market value of the shares in question as required in Explanation to Section 56 of the Act.

12. We find, in the said judgment, the matter was remanded to the Assessing Officer for fresh consideration on a concession extended by the assessee by submitting that they will seek necessary clarification from the Central Board of Direct Taxes and they may be permitted to do so while the matter could be remanded

back to the assessing authority. Therefore, a direction issued based on the concession extended by the assessee cannot be relied upon by the Revenue as a precedent.

13. *Thus, we find that both the CIT(A) and the Tribunal, on careful appreciation of the facts and circumstances, have granted relief to the assessee and we find there is no question of law, much less substantial question of law arise for consideration in this appeal.*

14. *Accordingly, the appeal filed by the Revenue is dismissed on the ground that there is no substantial question of law arise for consideration. No costs.”*

12.1. Thus, the Hon'ble Madras High Court has held that the option to choose the method provided under Clause-(a) or (b) is available with the assessee for determining the fair market value. DCF is one of the methods prescribed under the provisions of sec.56(2)(viib) read with Rule-11UA of I.T. Rules, 1962. The Assessing Officer cannot reject the method selected by the assessee for valuation of the shares. However, the Assessing Officer can scrutinize the contents or working of the method adopted by the assessee so as to find out the fair valuation. In case the Assessing Officer is not satisfied with the working of the assessee, then the Assessing Officer may do fresh valuation or get fresh valuation from an

Independent Valuer, but such fresh valuation can only be done as per the method adopted by the assessee. Accordingly, in the case in hand, adopting a different method, i.e., NAV by the Assessing Officer instead of DCF method of valuation as chosen by the assessee is a clear breach of jurisdiction and power on the part of the Assessing Officer which is not permissible. Even otherwise, the Assessing Officer cannot question the valuation as determined on the basis of prescribed method being DCF without pinpointing any specific inaccuracies or shortcomings.

12.2. Further, the Coordinate Bench of ITAT, Bangalore in the case of Pisces EServices (P.) Ltd. vs. DCIT [2024] 165 taxman.com 840 (Bangalore-Trib.) on identical facts has been held in Paras-20.2 to 20.4 as under:

“20.2. From the perusal of the above rule, it is transpired that option to choose the method provided under clause (a) or clause (b) is available with assessee. Admittedly, the method adopted by the assessee i.e. DCF method for determining fair market value was one of the methods prescribed under the provisions of section 56(2)(viib) read with income tax rule 11UA of Income Tax Rule. The AO cannot interfere in the method selected for the valuation of the shares. However, the AO can scrutinize the contents or working of the method adopted by the assessee so as to find out the fair

valuation. In case, the AO is not satisfied with the working of the assessee, then the AG may draw fresh valuation or get fresh valuation report from independent valuer, but such fresh valuation can only be done as per the method adopted by the assessee as in the present case assessee adopted DCF method. As such the AO cannot change the method from DCF to NAV method. In holding so, we draw support and guidance from the judgment of Hon'ble Bombay High Court in the case of Vodafone M-Pesa Ltd. v. Pr. CIT [2018] 92 taxmann.com 73/256 Taxman 240 (Bombay), where it was held as under:

9. *We note that, the Commissioner of Income-Tax in the impugned order dated 23 February, 2018 does not deal with the primary grievance of the petitioner. This, even after he concedes with the method of valuation namely, NAV Method or the DCF Method to determine the fair market value of shares has to be done adopted at the Assessee's option. Nevertheless, he does not deal with the change in the method of valuation by the Assessing Officer which has resulted in the demand. There is certainly no immunity from scrutiny of the valuation report submitted by the Assessee. Therefore, the Assessing Officer is undoubtedly entitled to scrutinise the valuation report and determine a fresh valuation either by himself or by calling for a final determination from an independent valuer to confront the petitioner. However, the basis has to be the DCF Method and it is not open to him to change the method of valuation which has been opted for by the Assessee. If Mr. Mohanty is correct in his submission that a part of demand arising out of the assessment order dated 21 December, 2017 would on adoption of DCF Method will be sustained in part, the same is without working out the figures. This was an exercise*

which ought to have been done by the Assessing Officer and that has not been done by him. In fact, he has completely disregarded the DCF Method for arriving at the fair market value. Therefore, the demand in the facts need to be stayed."

20.3 We also draw support and guidance from the order this Tribunal in case of *Innoviti Payment Solutions (P.) Ltd. v. ITO [2019] 102 taxmann.com 59/175 ITD 10 (Bangalore-Trib)*, the relevant observation of the coordinate bench reads as under:

14. In nutshell, our conclusions are as under-

- 1) *The AO can scrutinize the valuation report and the if the AO is not satisfied with the explanation of the assessee, he has to record the reasons and basis for not accepting the valuation report submitted by the assessee and only thereafter, he can go for own valuation or to obtain the fresh valuation report from an independent valuer and confront the same to the assessee. But the basis has to be DCF method and he cannot change the method of valuation which has been opted by the assessee.*
- 2) *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.*
- 3) *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.

20.4. *Thus, we are of the view that the AO has exceeded his jurisdiction by rejecting the method adopted by the assessee and brought another method for valuing the shares of the company. In view of the above we hold that the action of the AO by substituting the method for the valuation of shares which was subsequently upheld by the learned CIT(A) is contrary to the provisions of law and therefore the same is not sustainable.”*

12.3. Similarly, the Hon’ble Delhi High Court in the case of **Agra Portfolio (P.) Ltd. vs. PCIT [2024] 464 ITR 348 (Del.)** the Hon’ble High Court has held in Paras-15 to 22 as under:

“15. *A perusal of Rule 11UA(2) would indicate that the assessee is enabled to determine the FMV of the unquoted equity shares either in accordance with the formula prescribed in clause (a) or on the basis of a report drawn by a merchant banker who may have determined the FMV as per the DCF Method.*

16. *In our considered opinion, the language of Rule 11UA(2) indubitably places a choice upon the assessee to either follow the route as prescribed in clause (a) or in the alternative to place for the consideration of the AO a Valuation Report drawn by a merchant banker as per the DCF method. However, and as is manifest from a conjoint reading of Section 56(2)(viiB) read along*

with Rule 11UA(2), the option and the choice stands vested solely in the hands of the assessee.

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 along with 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 11U 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 / learned 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 ITD 502/ [2022] 94 ITR (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 unquoted 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 low 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 ie, 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, there needs to be tested and then such exemptions becomes 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 11UA(2) of the Rules. The provisions of Rule 11UA(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-Pesa Ltd. v. Pr. 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 ITAT, Bangalore in the case of VBHC Value Homes Pvt. Ltd., v. ITO (supra) ie., (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.”

12.4. Thus, the Hon’ble High Court has held that the Assessing Officer is not empowered to independently evaluate the value of the unquoted equity shares by adopting a valuation method other than the one chosen by the assessee. A similar view has been taken by the Hon’ble Gujarat High Court in the case of **Akash Ceramics (P.) Ltd. vs. ITO [2024] 168 taxmann.com 407 (Gujarat)**. Even the Assessing Officer in the remand report dated 30.09.2025 has accepted the DCF method as appropriate for fair market value as under:

“Introduction:

1. M/s Diabetomics Medical Private Limited, a closely held company, incorporated on 16.06.2015 with the objective of manufacturing and commercialization of medical diagnostic products relating to Diabetes and pregnancy for early diagnosis of Pre-eclampsia, Geostational Diabetes, Point-of-care test for Auto

Immune Diabetes, non-invasive saliva-based test for Type II diabetes. The said diagnostic products are first of its kind not only in India but also in the world.

2. The projections by the management regarding the future cash flows factored in the benefits, which the company would derive from technology involved i.e. technology transfer from US company, Innovative product, vast experience and reputation of the promoter in developing vaccines and innovative products in addition to the expected earnings / growth potential. Accordingly, the underlying projections were made on such reasonable assumptions as reflected in the Annexure to the Valuation Report and the preference shares were issued at a Premium of Rs. 710 per share. Further, while making the projections of future cash flows under DCF method, all standard methods were applied, for instance Terminal value is calculated adopting perpetual growth model.

3. While issuing the CCPS to third party as well as promoters, the appellant had valued CCPS as per the Discounted Cash Flow ('DCF') method based on aforesaid business plan of manufacture and commercialization of novel medical diagnostic products relating to diabetes and pregnancy and the same was duly certified by a Chartered Accountant as being the most appropriate method for valuing a newly started company as it has very little or no capital base.

A) Basis for valuation:

The assessee has submitted the data used by the assessee company M/s Diabetomics Medical Private Limited (DMPL) for projections of its sales that it is going to make to the foreign company M/s Diabetomics Inc. USA. The company M/s Diabetomics Inc. USA has given the projections of the product it is going to purchase from the assessee in the coming years from FY

2017-18 to FY 2021-22. The projections given by the management regarding the future cash flows were done by factoring the benefits which the company would derive from technology transfer by the US company. This data was arrived after taking into consideration of various demand factors and the drug required for meeting this demand in the open market. This estimation was used to arrive at the expected purchases that is going to be made by the foreign company M/s Diabetomics Inc. USA from the assessee company M/s DMPL. The submissions given by the assessee are perused. It is noticed that the assessee has used the DCF method to calculate the share value of the company. The entire calculations of the DCF workings have been perused. It is noticed that the assessee company M/s DMPL was going to produce a unique product and the patented technology was only available with the foreign company M/s Diabetomics Inc. USA. As the drug was unique, the market projections were done as per the estimated requirements. The workings which were used to arrive the share value as per DCF method has been certified by the Chartered Accountant.

B) Difference between ITR Data and Projections:

It is noticed that there is a huge difference between the ITR data of revenue and the projections. The assessee in its submissions stated that the product could not take off as planned and it faced a lot of problems in the take off process of the project. The assessee further stated that it faced problems due to COVID pandemic because of which the differences arised between the projections and the actual data filed in ITR.

The reply of the assessee along with documentary evidences submitted during the course of the remand proceedings by the assessee is attached herewith for your kind perusal.

In view of the above, the Ld. CIT(A) may take the decision on the issues based on the merits of the case.”

12.5. Accordingly, in the facts and circumstances of the case, the addition made by the Assessing Officer by adopting NAV method as against the DCF method chosen by the assessee for determination of the fair market value of the unquoted equity shares/CCPS is beyond the jurisdiction of the Assessing Officer and therefore, the same is not sustainable and liable to be deleted.

13. The second issue arises is regarding non-applicability of sec.56(2)(viib) of the Act in view of the proviso carving out an exception in case of a Venture Capital Undertaking. The term “Venture Capital Undertaking” is defined in clause-(b) of Explanation-2 Clause-(viib) of sub-sec.(2) of sec.56 as quoted in the foregoing part of this order. Thus, the Venture Capital Company and Venture Capital Undertaking shall have the meaning respectively assigned to them in clause-(a) to (c) of Explanation to sec.10(23FB) of the Act which reads as under:

“(23FB) any income of a venture capital company or venture capital fund [from investment] in a venture capital undertaking:

Provided that nothing contained in this clause shall apply in respect of any income of a venture capital company or venture capital fund, being an investment fund specified in clause (a) of the Explanation i to section 115UB, of the previous year relevant to the assessment year beginning on or after the 1st day of April, 2016.]

Explanation. For the purposes of this clause,-

(a) "venture capital company" means a company which-

(A) has been granted a certificate of registration, before the 21st day of May, 2012, as a Venture Capital Fund and is regulated under the Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 (hereinafter referred to as the Venture Capital Funds Regulations) made under the Securities and Exchange Board of India Act, 1992 (15 of 1992); or

(B) has been granted a certificate of registration as Venture Capital Fund as a sub-category of Category I Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (hereinafter referred to as the Alternative Investment Funds Regulations) made under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and which fulfils the following conditions, namely:-

- (i) it is not listed on a recognised stock exchange;*
- (ii) it has invested not less than two-thirds of its investible funds in unlisted equity shares or equity linked instruments of venture capital undertaking; and*
- (iii) it has not invested in any venture capital undertaking in which its director or a substantial shareholder (being a beneficial owner of equity shares exceeding ten per cent of*

its equity share capital) holds, either individually or collectively, equity shares in excess of fifteen per cent of the paid-up equity share capital of such venture capital undertaking;

(b) "venture capital fund" means a fund-

A) operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908), which-

- I. has been granted a certificate of registration, before the 21st day of May, 2012, as a Venture Capital Fund and is regulated under the Venture Capital Funds Regulations; or*
- II. has been granted a certificate of registration as Venture Capital Fund as a sub-category of Category I Alternative Investment Fund under the Alternative Investment Funds Regulations [or as referred to in sub-regulation (2) of regulation 18 of the International Financial Services Centres Authority (Fund Management) Regulations, 2022 made under the International Financial Services Centres Authority Act, 2019 (50 of 2019),] and which fulfils the following conditions, namely:-*

- (i) it has invested not less than two-thirds of its investible funds in unlisted equity shares or equity linked instruments of venture capital undertaking;*
- (ii) it has not invested in any venture capital under-taking in which its trustee or the settler holds, either individually or collectively, equity shares in excess of fifteen per cent of the paid-up equity share capital of such venture capital undertaking: [***];*
- (iii) the units, if any, issued by it are not listed in any recognized stock exchange; [and];*
- (iv) any other condition as may be prescribed^{37a}; or]*

(B) *operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963† (52 of 1963);*

(c) *"venture capital undertaking" means-*

(i) *a venture capital undertaking as defined in clause (n) of regulation 2 of the Venture Capital Funds Regulations; or*

(ii) *a venture capital undertaking as defined in clause (aa) of sub-regulation (1) of regulation 2 of the Alternative Investment Funds Regulations;]*"

14. Thus, as per Clause-(c) of Explanation to sec.10 (23FB) a Venture Capital Undertaking means a Venture Capital Undertaking as defined in Clause-(n) of Regulation-(2) of Venture Capital Fund Regulation or Venture Capital Undertaking as defined in Clause-(aa) of sub-regulation-(1) of regulation-(2) of Alternative Investment Fund Regulations. The Pune Bench of the Tribunal in the case of **ACIT, Central Circle vs. Sanghvi Beauty and Technologies (P.) Ltd., [2025] 215 ITD 588 (Pune-Trib.)** has considered the definition of "Venture Capital Undertaking" in Paras-6 to 9 as under:

“6. We have heard the rival contentions and perused the record placed before us. We note that the Revenue's grievance is only against the deletion of Rs. 10,33,59,732/- which has been received by the assessee from WEL against the issue of its Equity shares. Revenue's contention is that second proviso to section 56(2)(viih) is not applicable on the investment received from WEL.

7. Section 56(2)(viib) reads as under:

*"(viib) where a company, not being a company in which the public are substantially interested, receives". in any previous year, from any person.[***], any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares:*

Provided that this clause shall not apply where the consideration for issue of shares is received-

- (i) by a venture capital undertaking from a venture capital company or a venture capital fund for a specified fund), or*
- (ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf;*

Provided further that where the provisions of this clause have not been applied to a company on account of fulfilment of conditions specified in the notification issued under clause (ii) of the first proviso and such company fails to comply with any of those conditions, then, any consideration received for issue of share that exceeds the fair market value of such share shall be deemed to be the income of that company chargeable to income-tax for the previous year in which such failure has taken place and, it shall

also be deemed that the company has under reported the said income in consequence of the misreporting referred to in sub-section (8) and sub-section (9) of section 270A for the said previous year.

[Provided also that the provisions of this clause shall not apply on or after the 1st day of April, 2025.]

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 prescribed, 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, licenses, franchises or any other business or commercial rights of similar nature, whichever is higher,*

[(aa) "specified fund" means a fund established or incorporated in India in the form of a trust of a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category 1 or a Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Funda) Regulations, 2012 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) 42(or regulated under the "[International Financial Services Centre Authority (Fund Management) Regulations, 2022 made under the] International Financial Services Centres Authority Act, 2019 (50 of 2019));

(ab) "trust" means a trust established under the Indian Trusts Act, 1882 (2 of 1882) or under any other law for the time being in force]

(b) "venture capital company", "venture capital fund" and "venture capital undertaking" shall have the meanings respectively assigned to them in clause (a), clause (6) and clause (c) of "[Explanation) to clause (23FB) of section 10;]"

8. On perusal of the above section, we note that as per clause (1) of first proviso section 56(2)(viib) of the Act will not be applicable if the consideration for issue of share is received by a Venture Capital Undertaking from a Venture Capital Company or Venture Capital fund or a specified fund. We further observe that Id. CIT(A) while deleting the impugned addition has dealt with the investments received from Ascent Private Equity Trust and Mis. Wipro Enterprise Limited observing as follows:

"Findings:

6.1. I have considered the assessment order, the statement of facts and the submission made by the appellant. In this case, the Ld. AD made an addition of Rs. 56,58,16,902/- under section 56(2)(vii)(6) towards the premium received from Wipro-Enterprise Limited(Wipro) and Ascent Private Equity Trust(Ascent). The details of shares and the valuation are as under:

Sr. No.	Name of the Shareholder	No. of CCPS/ equity shares issued	Issue price per share (INR)	Assessed price per share (INR)	Amount Added
1.	Ascent	4,160	1,61,077	50,176	46,13,48,160
2.	Ascent	10	1,61,077	50,176	11,09,010
3.	Wipro	932	1,61,077	50,176	10,33,59,732
					56,58,16,902

During the assessment proceedings, the Ld. AO noticed that the appellant has issued shares at a premium to various resident and non-resident applicants at a price of Rs. 50,176/- per share and at a price of Rs. 1,61,077, Since the shares are not issued at face value, the Ld. AO held that provisions of Sec. 56(2) (i) get instantly attracted to this transaction. In the assessment order, the Ld.AO has rejected the valuation report made by Category I Merchant Banker viz. V.B. Desai Financial Services Ltd, dated 31.12.2020 and restricted the share premium to Rs. 50,176/- as against Rs. 1,61,077 as per valuation report dated 30.04.2020. The appellant has submitted two valuation reports during the assessment proceedings. Both the valuation reports were prepared by V.B. Desai Financial Services Ltd, a Category I Merchant Banker.

6.2. *The Ld. AO rejected the said valuation report on the following grounds.*

As per the Balance Sheet submitted by the assessee company, significant amount of debt is taken by the assessee company. However, while computing the weighted average cost of capital in the valuation, report, it is not evident whether cost of debt is considered and if it is, what is debt equity ratio that is considered. Weighted Average cost of capital (WACC) is computed on the basis of the actual debt equity ratio in the balance sheets which is applied to the cost of equity and cost of debt. Thus, in absence of any explanation, the WACC at 20% is not acceptable.

For the purpose of calculating terminal value of the business, the valuation report suggests that a growth rate of 5% is taken. Again, it is an assumption. It is imperative to

understand that growth rate should be correlated with the date of valuation and the industry in which the appellant is operating as on the date of valuation. The CAGR for the sector of beauty products is less than 4% especially in post-covid scenarios. Therefore, the CAGR adopted by assessee company cannot be accepted.

Further, there is no basis for projecting the results for future years, be it sales cost, depreciation, capex or Net Working Capital. No basis is provided at all.

Also, the company is a private limited company and is not a listed company. The value which has been determined is not a fair estimated value also because of the fact that the shares of private limited company are discounted for lack of liquidity and marketability. However, it is not clear whether the valuer has considered the same at all.

6.3. *The appellant has argued that the first proviso to section 56(2) (vii)(b) expressly exempts the amounts received by a Venture Capital Undertaking (VCU) from an Alternative Investment Fund (AIF), towards issue of shares, from the applicability of the provisions of said section. As per the first proviso to section 56(2)(viib) of the Act, the consideration for issue of shares received by a Venture Capital Undertaking from specified fund shall be outside the rigors of section 56(2)(vib) of the Act. Therefore, for falling into the exemption, two conditions are to be satisfied-*

- 1. Assessee needs to be a Venture capital undertaking (VCU) and*
- 2. Investor should be one of the specified persons, le. in the present case, Specified Fund (SF).*

6.4 In the present case, the investor is Ascent. As per Explanation to section 56(2)(viib) of the Act, 'specified fund' means a fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category 1 or a Category II Alternative Investment Fund and regulated under SEBI (Alternative Investment Fund) Regulations 2012. As submitted by the appellant, Ascent is registered as Securities and Exchange Board of India ('SEBI') Category II Alternative Investment Fund ('AIF') effective from 7 August 2017 (Copy of the registration certificate is also submitted by the appellant). Thus, the appellant has argued that given the express exemption to a 'Specified Fund' from the applicability of provisions of section 56(2)(viib) of the Act, no addition ought to be made in respect of the amount received from Ascent. Further, as per the Explanation to section 56(2)(viib), the terms "venture capital company", "venture capital fund" and "venture capital undertaking" shall have the meanings respectively assigned to them in clause (a), clause (6) and clause (c) of Explanation to clause (23FB) of section 10. As per Clause (c) of Explanation to clause (23FB) of section 10 of the Act. 'venture capital undertaking' shall be a venture capital undertaking as defined in clause (n) of regulation 2 of the Venture Capital Funds (VCF) Regulations; OR clause (aa) of sub-regulation (1) of regulation 2 of the Alternative Investment Funds ('AIF') Regulations.

As per clause (aa) of the AIF Regulations (prior to amendment), "venture capital undertaking" means a domestic company:

- (i) which is not listed on a recognised stock exchange in India at the time of making investment, and

(ii) *which is engaged in the business for providing services, production or manufacture of article or things and does not include following activities or sectors:*

- 1) non-banking financial companies,*
- 2) gold financing.*
- 3) activities not permitted under industrial policy of Government of India.*
- 4) any other activity which may be specified by the Board in consultation with Government of India from time to time.*

6.5. *The Appellant has been incorporated on 12 August 2015 as a private limited entity. Further, the appellant undertakes manufacturing of its products, markets and sells the said products under its brand name 'Myglamin'. Therefore, the appellant argued that as it is engaged in the manufacturing of varieties of beauty, cosmetic and skin care products, and being an unlisted entity thereby fulfilling both the aforesaid conditions and consequently ought to be considered to be a 'Venture Capital Undertaking' as per the AIF Regulations. The appellant contended that on account of specific exemption provided in section 56(2)(viib) to the venture capital undertaking receiving consideration from specified funds, the said addition of Rs.46,24,57,170/-made by the Lil. AO is, therefore, unwarranted and deserves to be deleted.*

Similarly, as regards to the amount of disallowance of Rs 11,09,010/- in respect of Ascent Private Equity Trust and Rs. 10,33,59,732/- in respect of Wipro Enterprises Ltd is concerned, the appellant submitted that as per rule 2, sub rule 2(A)(e) of GSR 685(E) no disallowance is warranted in the case of the appellant. The relevant portion of the sub rule is reproduced hereunder:

"(c) where any consideration is received by a venture capital undertaking for issue of unquoted equity shares, from a venture capital fund or a venture capital company or a specified fund, the price of the equity shares corresponding to such consideration may, at the option of such undertaking, be taken as the fair market value of the equity shares to the extent the consideration from such fair market value does not exceed the aggregate Consideration that is received from a venture capital fund or a venture capital company or a specified fund:

Provided that the consideration has been received by the undertaking from a venture capital fund or a venture capital company or a specified fund, within a period of ninety days before or after the date of issue of shares which are the subject matter of valuation.

Explanation - For the purposes of this clause-

- (i) "specified fund" shall have the same meaning as assigned to it in clause (aa) of Explanation to clause (viib) of sub-section (2) of section 56;*
- (ii) "venture capital company", "venture capital fund" and "venture capital undertaking shall have the same meaning assigned to them in clause (b) of Explanation to clause (viib) of sub-section (2) of section 56.*

Illustration: If a venture capital undertaking receives a consideration of fifty thousand rupees from a venture capital company for issue of one hundred shares at the rate of five hundred rupees per share, then such an undertaking can issue one hundred shares at this rate to any other investor within a period of ninety days before or after the receipt of consideration from venture capital company."

6.6. *The appellant has relied on the case of Hon'ble ITAT Delhi Bench in the case of ACIT v. Drishti Sofi Solutions Pvt. Ltd. (ITA No. 8523/Del/2019) wherein it was held that section 56(2)(vii) (b) would not be applicable where consideration for issued of shares is received by a venture capital undertaking from a venture capital company or venture capital fund. Further, reliance is also placed on the decision of the Kolkata bench of the Hon'ble ITAT in the case of Milk Mantra Dairy Pvt. Ltd. v. Deputy Commissioner of Income-tax (ITA No. 413/Kol/2020) wherein it was held that transaction of issue of shares by venture capital undertaking to venture capital company or venture capital fund is squarely covered by first proviso to section 56(2)(vi) (b) wherein it has been stated that said section shall not apply.*

6.7 *The appellant also placed reliance on the decision of the Delhi bench of Hon'ble ITAT in the case of Bigfoot Retail Solution Pvt. Ltd. ACTI (ITA No. 3161/Del/2016) wherein also it has been held that since assessee fulfils the requisite condition of being a venture capital undertaking, it falls within the ambit of the exclusionary provision contained in the first proviso to section 56(2)(vii)(6) when consideration is received from a venture capital undertaking.*

6.8. *In view of the above discussion, it is held that the appellant being a Venture Capital Undertaking, the investments made by the SEBI registered Alternate Investment Fund are not subject to rigors of the provisions of section 56(2)(viib) of the Act and hence no additions on these count are warranted. The addition made by the AO u/s 56(2) (viib) on account of Share Premium u/s 56(2)(viib) of the Act amounting to Rs.56,58,16,902/- is therefore deleted. The ground no. 8 of the appeal is hereby allowed. The contention of the appellant in the ground no. 3 is therefore allowed in this regard."*

9. *Now on going through the above finding, we notice that the basis of relief given by Id. CIT(A) is that since the appellant is a Venture Capital Undertaking and investments have been made by a SEBI registered alternate investment fund therefore such investments are not subject to rigors of provisions of section 56(2)(viib) of the Act. However, before us, Id. Counsel for the assessee has fairly admitted that WEL. is not a SEBI registered alternate investment fund and that Id. CIT(A) while dealing with the issue of investments received from Ascent Private Equity Trust and WEL, has taken the basis of Ascent Private Equity Trust which is a SEBI registered alternate investment fund and therefore while giving relief to the assessee Id. CTT(A) failed to take note that WEL is not a SEBI registered alternate investment fund. Therefore, the very basis of giving relief to the assessee by Id. CIT(A) is incorrect. However, since the assessee has furnished various other details of WEL in support of its contention that source of the investment is duly explained along with relevant documentary evidences and the shares have been issued at Fair Market Value arrived at by the Registered Valuer applying Discounted Cash Flow method, we deem it appropriate that the issue deserves to be restored back to the file of Id. CIT(A) for afresh adjudication in light of the details filed before this Tribunal.”*

15. Thus, as per Clause-(n) of Regulation-2 of the Venture Capital Fund Regulation or Clause-(aa) of sub-regulation-(1) of Regulation-2 of Alternative Investment Fund [AIF] Regulations, a Venture Capital Undertaking means, ‘a domestic company’ which is not listed on a recognized stock

exchange in India at the time of making the investment and which is engaged in the business of providing services, production or manufacture of article or thing and does not include the activities in the negative list provided by the SEBI such as NBFC, gold financing and any other activity not permitted under Industrial Policy of the Government of India or which may be specified by the SEBI in consultation with Government of India. In case in hand as per the particulars of CCPS issued to the Venture Capital Fund it is clear that the assessee company received the investment from Venture Capital Fund and also satisfied the conditions as per the definition provided under clause-(n) of Regulation-(2) of Venture Capital Fund or Clause-(aa) of sub-regulation-(1) of Regulation-(2) of Alternative Investment Fund. Thus, a Venture Capital Undertaking is essentially a unlisted domestic company in India i.e. originally to receive investment from a Venture Capital Fund or Category-1 AIF under SEBI Regulations. It must be engaged in the business of providing services, production or manufacturing of goods subject to the exclusion of the activities as referred above. It

is also a matter of fact that the Venture Capital Fund generally invests in a Start-Up Company for taking early stage high risk but with high growth potential as these companies engaged in the innovative product, services or technology. Thus, the investment made by the Venture Capital Fund/Trust in the shares of the assessee company itself establishes the fact that the assessee falls in the definition of “Venture Capital Undertaking” and consequently, falls in the exception as provided in proviso to Clause-(viib) of sub-sec.(2) of sec.56 of Income Tax Act, 1961.

16. The Assessing Officer in the remand report dated 13.03.2025 has given the findings in Para-3.1 to 4 as under:

“3.1. The submissions made have been duly considered. It is clear that the company has commenced the setting up of business based on the licenses obtained and incurring expenditure on capital works which is reflected in the balance sheet as capital work in progress. Initially, at the time of incorporation of Diabetomics Medical (P) Ltd (herein after called DMPL), Diabetomics INC(is a global medical diagnostic company pioneering innovative, non-invasive point-of-care test for detection and monitoring of diabetes) was already in a commercial relationship with global diagnostic major, Becton Dickenson (BD) for manufacture and supply of a point of care test for early diagnosis of Pre-eclampsia in pregnancy and diabetes. This test was supposed to be

exclusively manufactured for global supplies by Diabetomics Medical (P) Ltd. For this purpose, DMPL entered in a contract manufacturing agreement with UBIO technologies, Cochin, Kerala(loan Licence Agreement dated 26 October, 2015) to utilize their existing manufacturing facility. A separate LOAN LICENCE was obtained from the Drugs Control Authority, Kerala. (Licence #46/28A/16, dated 4 October, 2016). However, due to unforeseen business developments, BD did not commercialise the product as projected due to their internal constraints. Therefore, Diabetomics INC did not get the products manufactured by DMPL as initially planned. Subsequently, DMPL manufacturing facility was created and licenses were obtained. From the above events it is clear that the appellant company is engaged in the business and therefore entitled to be treated as venture capital undertaking.

3.2. *The Ventureast Funds which has invested in the appellant company is registered as a venture capital fund by SEBI as per the regulation 7(3) of the Securities and Exchange Board of India (Venture Capital Funds) regulations, 1996 vide certificate of registration number IN/VCF/09-10/144 dated 29.05.2009. Therefore, the investment made by this fund in the appellant company is not hit by the provisions of the section 56(2)(vii)(b). Therefore, the investment by this venture fund in the shares of the appellant company which is a venture capital undertaking of Rs.6,60,69,050/- cannot be treated as income of the appellant company.*

3.3. *The promoter investor, Dr. K.I. Varaprasad Reddy, also invested in the appellant company at the same premium as that of Ventureast Funds. The appellant company couldn't have allotted shares to him at a rate lower than that of the Ventureast Funds. Further, Dr. K.I. Varaprasad Reddy has adequate sources*

of income as seen from the returns filed for A.Ys. 2016-17 wherein he declared an income of Rs.28,27,17,940/- and paid taxes to the tune of Rs.7,06,21,601/-. It may be noted that Dr. K.I. Varaprasad Reddy was the promoter of M/s. Shanta Biotech Pvt. Ltd. (now acquired by M/s. Sanofi Aventis Group) which was the first Indian company to develop and manufacture Hepatitis B vaccine which is approved by the WHO and supplied to various UN agencies. As regards the sources of investment, they are clearly explained and further that the premium charged to him is same as that charged to the venture capital fund. Considering these facts, the said investment of Rs.2,95,82,150/- cannot be considered as income of the appellant company.

4. *Considering the submissions made by the appellant and for the reasons cited above the addition made of Rs.9,56,51,200/- is not tenable. The CIT(A) may take into consideration the above submissions while deciding the appeal.”*

17. Accordingly, we are of the view that the Assessing Officer has accepted the status of the assessee as Venture Capital Undertaking and consequently, the addition to the extent of CCPS issued to Venture Capital Fund is not tenable. Further, the provisions of sec.56(2)(viib) of the Act are not applicable in the case of the assessee to make the addition on account of receipt of the share price in excess of fair market value of the shares from Venture Capital Fund. This common issue involved in two assessment years i.e., for the

assessment years 2016-2017 and 2017-2018 is decided in favour of the assessee and consequently, the additions made by the Assessing Officer u/sec.56(2)(viib) of the Act *qua* the CCPS issued to Venture Capital Fund are deleted.

18. For the assessment year 2016-2017, the learned Authorised Representative of the Assessee has stated at Bar that the assessee does not press ground no.11 and the same may be dismissed as not pressed. The learned DR has submitted that he has no objection if ground no.11 of the assessee's appeal is dismissed as not pressed. Accordingly, ground no.11 of the assessee's appeal is dismissed being not pressed.

ITA.No.2148/Hyd./2025 – A.Y. 2017-2018 :

19. The assessee has raised the following grounds in the instant appeal:

- 1) *“The order of the Ld. CIT(Appeals) is erroneous on the facts of the case and contrary to the provisions of law.*
- 2) *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) erred in sustaining the addition of Rs.69,51,024/- made u/s 56(2)(viib) of the Act in respect of*

Compulsorily Convertible Preference Shares (CCPS) issued at a premium by the appellant company.

- 3) *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) ought to have held that the AO has grossly erred in rejecting the fair market value (FMV) of unquoted equity share as determined by a Chartered Accountant in his valuation report as per the Discounted Free Cash Flow (DCF) method in accordance with Rule 11UA(2) of the Income Tax Rules, without proper and justifiable reasons.*
- 4) *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) ought to have appreciated that Rule 11UA(2) provides an option to the assessee to adopt either the NAV (Net Asset Value) or the CF method for determining the FMV of the unquoted equity share and the FMV determined by the AO by applying a method which is not opted by the assessee is legally unsustainable since the AO has no power under the Act to change the method of valuation adopted by the assessee.*
- 5) *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) erred in concurring with the view of the Assessing Officer that the appellant company cannot be regarded as a Venture Capital Undertaking so as to be eligible for exemption from the application of the provisions of section 56(2)(viib) as per the first proviso thereunder on the ground that the appellant company cannot be considered to be engaged in the business" of providing services, production or manufacture of article or things since admittedly it has not commenced its business operations.*
- 6) *The Ld. CIT(A) ought to have appreciated that the expression "engaged in the business" cannot be equated with the expression "commencement of business", as it is a*

settled position in law that an assessee can be said to be engaged in business once it begins the setting up of the business.

- 7) The Ld. CIT(A) ought to have held in the facts of the case that the appellant is engaged in business since it has begun to set up its business and it is eligible for exemption from the applicability of the provisions of section 56(2)(viib), being a venture capital undertaking, in respect of consideration received for issue of CCPS from a Venture capital company/fund, as per the first proviso thereunder.*
- 8) On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) erred in not holding that the provisions of section 56(2)(viib) are applicable to issuance of equity shares only and the said provisions are not applicable to issuance of Compulsorily Convertible Preference Shares (CCPS) by the appellant.*
- 9) On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) ought to have appreciated that the legislative intention behind introduction of section 56(2)(vilb) is to prevent generation and circulation of unaccounted money and ought to have held that the facts of the appellant case do not warrant invoking of the said provisions.*
- 10) On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) erred in sustaining the addition of interest on bank deposits of Rs.7,43,992/-under the head income from other sources. The Ld. CIT(A) ought to have held in the facts of the case that the said interest income requires to be capitalized, being incidental to the setting up of the manufacturing project and is not to be taxed as income from other sources.*

11) *Any other legal grounds or factual grounds that may be urged at the time of hearing of the appeal.”*

20. Ground No.1 is general in nature and does not require any specific adjudication.

21. The issue raised in ground nos.2 to 9 is common to the issue raised in assessment year 2016-2017 which has been decided by us in favour of the assessee in foregoing paras hereinabove and hence, for this assessment year 2017-2018 also, our observations made for assessment year 2016-2017 in preceding paragraphs hereinabove shall follow *mutatis mutandis*.

22. For the assessment year 2017-2018, the learned Authorised Representative of the Assessee has stated at Bar that the assessee does not press ground no.10 and the same may be dismissed as not pressed. The learned DR has submitted that he has no objection if ground of appeal no.10 of the assessee's appeal is dismissed as not pressed. Accordingly, ground no.10 of the assessee's appeal is dismissed being not pressed.

ITA.No.2149/Hyd./2025 – A.Y. 2018-2019 :

23. The assessee has raised the following grounds of appeal:

- 1) *“The order of the ld. CIT(Appeals) is erroneous on the facts of the case and contrary to the provisions of law.*
- 2) *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) erred in sustaining the addition of Rs.1,16,55,450/- made u/s 56(2)(viib) of the Act in respect of Compulsorily Convertible Preference Shares (CCPS) issued at a premium by the appellant company.*
- 3) *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) ought to have held that the AO has grossly erred in rejecting the fair market value (FMV) of unquoted equity share as determined by a Chartered Accountant in his valuation report as per the Discounted Free Cash Flow (DCF) method in accordance with Rule 11UA(2) of the Income Tax Rules, without proper and justifiable reasons.*
- 4) *On the facts and circumstances of the case and in law, the Ld. CIT-(Appeals) ought to have appreciated that Rule 11UA(2) provides an option to the assessee to adopt either the NAV (Net Asset Value) or the DCF method for determining the FMV of the unquoted equity share and the FMV determined by the AO by applying NAV method which is not opted by the assessee is legally unsustainable since the AO has no power under the Act to change the method of valuation adopted by the assessee.*

- 5) *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) erred in not holding that the provisions of section 56(2) (viib) are applicable to issuance of equity shares only and the said provisions are not applicable to issuance of Compulsorily Convertible Preference Shares (CCPS) by the appellant.*
- 6) *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) ought to have appreciated that the legislative intention behind introduction of section 56(2)(viib) is to prevent generation and circulation of unaccounted money and ought to have held that the facts of the appellant case do not warrant invoking of the said provisions.*
- 7) *On the facts and circumstances of the case and in law, the Ld. CIT(Appeals) erred in sustaining the disallowance of depreciation of Rs.11,15,834/-. The Ld. CIT(A) ought to have held in the facts of the case that the appellant is eligible for the depreciation since the assessee has set-up the business, though business has not commenced.*
- 8) *Any other legal grounds or factual grounds that may be urged at the time of hearing of the appeal.*

24. Ground No.1 is general in nature and does not require any specific adjudication.

25. The issues raised in ground nos.2 to 6 are common to the issue raised in assessment year 2016-2017 which has been decided by us in favour of the assessee in foregoing paras hereinabove and hence, for this assessment year 2018-

2019 also, our observations made for assessment year 2016-2017 in preceding paragraphs hereinabove shall follow *mutatis mutandis*.

26. Grounds of appeal no.7 are regarding the disallowance of depreciation.

27. The learned Authorised Representative of the Assessee has submitted that the assessee reported loss in the return of income and depreciation was part of the loss declared by the assessee. The Assessing Officer has disallowed the loss as declared in the return of income by treating the business income at Rs.NIL and also made the addition u/sec.56(2)(viib) as well as disallowance of depreciation. Thus, he has submitted that there is a double disallowance/addition of income while making a separate disallowance of depreciation apart from the disallowance of loss as declared in the return of income. He has thus submitted that the disallowance made by the Assessing Officer on account of depreciation is liable to be deleted as already part of the loss declared by the assessee in the return of income.

28. On the other hand, the learned DR has submitted that the Assessing Officer may be directed to verify and consider this aspect.

29. We have considered the rival submissions as well as carefully perused the impugned order of the Assessing Officer. The assessee filed the return of income for the assessment year 2018-2019 on 31.10.2018 declaring loss of Rs.1,06,55,965/- in the normal provisions of the Act. The Assessing Officer disallowed the loss returned by the assessee while computing the total income of the assessee in Para-5 of assessment order as under:

<i>Loss Returned</i>	<i>(-) Rs.1,06,55,965/-</i>
<i>Assessed Business Income/Loss</i>	<i>Rs. NIL</i>
<i>Add: Addition u/s.56(2)(viib)</i>	<i>Rs.1,16,55,450/-</i>
<i>Add: Disallowance of depreciation</i>	<i>Rs. 11,15,834/-</i>
<i>Assessed Income from Other Sources</i>	<i>Rs.1,27,71,284/-</i>

30. Thus, instead of the loss returned by the assessee the Assessing Officer took the business income at Rs.NIL and thereby disallowed the loss which includes the depreciation of Rs.11,15,834/-. *Prima facie*, it appears that a separate addition made by the Assessing Officer on account of

disallowance of depreciation amounts to double addition/
disallowance. Accordingly, the Assessing Officer is directed to
verify this fact and in case, the loss declared by the assessee
includes the amount of depreciation of Rs.11,15,834/-, then
the addition is liable to be deleted.

31. In the result, all the three appeals of the Assessee
are partly allowed. A copy of this common order be placed in
the respective case files.

Order pronounced in the open Court on 11.02.2026.

Sd/-
[MADHUSUDAN SAWDIA]
ACCOUNTANT MEMBER

Sd/-
[VIJAY PAL RAO]
VICE PRESIDENT

Hyderabad, Dated 11th February, 2026

VBP

Copy to:

1.	DIABETOMICS Medical Private Limited, 6-3-349/31, Dwarakpuri Colony, Punjagutta, Hyderabad-500082.
2.	The ACIT, Circle-8(1), Signature Towers, Sy.No.6(P) of Kondapur, Sy.No.37(P) of Kothaguda, Opp. Botanical Gardens, Serilingampally (M), Ranga Reddy, Hyderabad – 500 084.
3.	The Pr. CIT, Hyderabad.
4.	The DR, ITAT, “A” Bench, Hyderabad.
5.	Guard file.

BY ORDER