Delhi Tribunal's double relief: No tax on CCPS reclassification; no arbitrary switch from DCF to NAV can be made by AO

Compulsorily Convertible Preference Shares ("**CCPS**") are frequently used by companies to raise capital. Whether a mere accounting reclassification of CCPS from borrowings to share capital and securities premium as mandated under Indian Accounting Standards **('Ind-AS')**—without receipt of any fresh consideration—can trigger taxation under section 56(2)(viib) of the Income-tax Act, 1961 ("**the Act**")?

In the recent decision in the case of **Bright Lifecare Private Limited**[1], the Delhi Bench of the Tribunal has held that section 56(2)(viib) of the Act cannot be invoked merely because CCPS issued in earlier years were reclassified from borrowings to share capital and securities premium pursuant to changes in their contractual terms and the applicable accounting treatment, where no consideration was received during the relevant year. The Tribunal accordingly deleted the addition of Rs.814.40 crores. It further held that a share valuation undertaken by a merchant banker using the prescribed discounted cash flow ("**DCF**") method cannot be rejected solely because the projections subsequently differed from actual performance or be substituted by the net asset value ("**NAV**") method at the Assessing Officer's discretion.

Background

The assessee maintained its financial statements under the mandatory Indian Generally Accepted Accounting Principles **('IGAAP')** till 31.03.2020. In terms of IGAAP, the CCPS issued by assessee from FY 2011-12 to FY 2019-20 were accounted for as 'Share Capital' and 'Securities Premium'.

However, upon transition to Ind-AS, the assessee, as per Ind-AS 32, classified the CCPS as 'financial liability/ Borrowings', as the agreement entered into between the assessee and CCPS holders contained a 'Buyback' obligation.

Pertinently, during FY 2022-23 relevant to the AY 2023-24, the CCPS agreements entered into earlier between the assessee and CCPS holders were revised, resulting in deletion of the 'Buyback' clause; as a result, the Buyback obligation of the assessee was extinguished. Consequently, the CCPS issued in the earlier years, i.e., FYs 2011-12 to 2019-20 were reclassified from 'Borrowings' to 'Share Capital' and 'Securities Premium' during relevant AY 2023-24.

In the ensuing assessment, the Assessing Officer ("**AO**") made an addition under section 56(2)(viib) on account of reclassification of CCPS from 'Borrowings' to 'Securities Premium' account.

Further, the AO also made another addition under section 56(2)(viib) of the Act on account of share premium received by the assessee from issue of equity shares to resident shareholders.

The Commissioner (Appeals) affirmed the assessment, leading to the appeal before the Tribunal.

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[1] Bright Lifecare Pvt. Ltd. vs. DCIT: ITA No. 5198/Del/2026; Order dated 18.09.2026

<u>Tribunal's ruling</u>

The Tribunal, relying on the decision of Himachal Pradesh High Court in the case of **PCIT vs. IA Hydro Energy (P.) Ltd.**[2] held that provisions of section 56(2)(viib) clearly mandate receipt of consideration for issue of shares at a price exceeding the fair market value of the shares. The provisions of section 56(2)(viib) of the Act, applied by the Revenue are not applicable per se for the transaction carried out by assessee.

According to the Tribunal, the suo moto disallowance made by the assessee in various years on account of reclassification, had not been appreciated by the Revenue, thereby resulting in double addition.

The Tribunal further held that there is absolutely no colorable device adopted by the assessee; on the contrary, the assessee had made full and true disclosure in its financial statements qua the said transaction by giving a detailed note in its audited financial statements and the purpose of the amount getting credited to securities premium account. Accordingly, the Tribunal deleted the said addition made under section 56(2)(viib) of the Act.

Further, in respect of other addition also made under section 56(2)(viib) of the Act, the Tribunal relying upon the decision of the Delhi Tribunal in the case of **Cinestaan Entertainment (P.) Ltd. vs. ITO**[3] (affirmed by Delhi High Court) held that the assessee had justified the share premium by furnishing the valuation report obtained from a merchant banker who had valued the fair market value of the shares using DCF method, which is one of the prescribed methods under Rule 11UA of the Income Tax Rules, 1962 ('**the Rules**'); the assessing officer cannot substitute the said valuation report by adopting NAV method which is also another recognized method prescribed under Rule 11UA of the Rules.

The Tribunal further held that merely because the projections used in the valuation report did not match with the actual financial performance of the assessee, the said valuation report cannot be rejected at once which would amount to questioning the wisdom of an independent professional. Accordingly, the Tribunal also deleted the said addition made under section 56(2)(viib) of the Act.

VA Comments

The Tribunal vide aforesaid decision has granted a substantial relief to the assessee by holding that actual <u>receipt of consideration during the relevant year</u> is mandatory for invoking provisions of section 56(2)(viib) of the Act. The ruling also accords primacy to the principle taxability under the Act as opposed to the accounting treatment accorded by the assessee. Further, the Tribunal has reiterated the position that deviation from actual financial results does not result in the valuation under Rule 11UA of the Rules obtained on the basis of projected figures, being rejected and substituted by other method.

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[2] *PCIT vs. IA Hydro Energy (P.) Ltd.* [2024] 299 Taxman 304 (HP)

[3] *Cinestaan Entertainment (P.) Ltd. vs. ITO* [2019] 106 taxmann.com 300 (Delhi - Trib.) – affirmed by Delhi High Court in [2021] 433 ITR 82 (Delhi)

For any further clarification, please write to:

Mr. Aniket D. Agrawal
Partner
aniket.agrawal@vaishlaw.com

Ms. Aditi Garg
Associate
aditi@vaishlaw.com

Corporate, Tax and Business Advisory Law Firm

DELHI	MUMBAI	BENGALURU
1st, 9th, 11th Floor, Mohan Dev Building, 13, Tolstoy Marg, New Delhi, 110001 (India)	106, Peninsula Centre, Dr. S.S. Rao Road, Parel, Mumbai, 400012 (India)	Bhive Premium Ramanashree (MG Road) No. 2/1, Brunton Road, Off MG Road, Opposite Old Passport Office Bengaluru, 560001 (India)
+91 11 42492525 delhi@vaishlaw.com	+91 22 42134101 mumbai@vaishlaw.com	+91 80 40903588 / 89 bangalore@vaishlaw.com