Final rules for the valuation of unquoted equity shares

July 19, 2017

In brief

On 12 July, 2017, the Central Board of Direct Taxes (CBDT) has issued final rules for the determination of fair market value (FMV) of unquoted equity shares for the purposes of section 56(2)(x) and section 50CA of the Income-tax Act, 1961 (the Act). The rules apply to all the transactions taxable during financial year(s) ending on or after 01 April, 2017. The final rules are broadly in line with the draft rules released by the CBDT in May this year.

In detail

Background

- The Finance Act, 2017 had brought into force two major amendments in the Income Tax Act;
 - Insertion of clause (x) in section 56(2) to provide that receipt of money or specified property by any person for inadequate consideration or without consideration from any person shall be subject to tax.
 - Introduction of section 50CA to provide that where consideration for transfer of shares of a company other than a quoted share is less than the FMV of such a share, the FMV determined as per the Rules shall be deemed to be the full value of consideration for computing income under the head "capital gains."
- The CBDT on o5 May, 2017 issued a draft notification

- that proposed to amend Rule 11UA and introduce Rule 11UAA for computing the FMV of unquoted shares of a company for the purpose of sections 56(2)(x) and 50CA respectively.
- Recently, on 12 July 2017, the CBDT has issued final notification in this regard. The final rules are largely similar to the draft rules and are applicable to all transactions taxable during financial year's ending commencing on or after 01 April, 2017.

Final Valuation Rules

• Final Rule 11UA(1)(c)(b) replacing the existing rule prescribes computation of FMV of the unquoted equity shares as follows:

$$FMV = (A + B + C + D - L) \times (PV)/(PE)$$

where,

A = book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in

the balance sheet as reduced by

- (i) any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any, and
- (ii) any amount shown as asset including the unamortised amount of deferred expenditure that does not represent the value of any asset:
- B = the price that the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer;
- C = FMV of shares and securities as determined according to this rule;
- D = the value adopted or assessed or assessable by any authority of the government for the purpose of payment



- of stamp duty in respect of the immovable property;
- 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 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 income-tax paid, if any, less the amount of income-tax claimed as refund, if any, 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;
- New Rule 11UAA prescribes that for the purposes of section 50CA, the FMV of the share of a company other than a quoted share, shall be determined as provided in Rule 11UA(1)(c)(b)/(c), and that the reference to valuation date in the rule 11U and rule 11UA shall mean the date on which such shares are transferred.

Amounts marked as bold & italic represents the changes made in final rules as compared to the draft rules.

The takeaways

Erstwhile Rule 11UA(1)(c)(b) determined FMV of unquoted equity shares wholly on the basis of book value of the company without considering valuation impact relating to assets for which specific valuation rules were provided and thus, there was an inconsistency in direct and indirect valuation of certain assets. The amended rule 11UA(c)(b) removes above inconsistency and provides valuation adjustment for such assets in valuation of unquoted equity shares of company holding such assets. Valuation of rest of the assets,

- including assets such as intangible assets, business undertaking, investment held in Limited Liability Partnership or partnership firm etc., and liabilities of the company continues to be valued at book value.
- Newly inserted Rules 11UAA provides valuation methodology to be adopted for the purpose of new section 50CA. It provides that equity shares covered thereunder should be valued as per above Rule 11UA(1)(c)(b) and preference shares should be valued as per Rule 11UA(1)(c)(c) which provides for valuation it will fetch if sold in open market.
- Final Rules have not addressed some issues which were necessary and were expected to be addressed:
 - Adoption of actual fair value, in case the FMV of immovable property is less than the Stamp Duty Value;
 - Reduction in relation to securities premium payable on redemption of preference shares,
 - Rules being notified on 12th
 July, 2017 and being made
 effective from 01 April,
 2017, relaxation should
 have been provided to
 transactions entered
 between 01 April, 2017 and
 12 July, 2017.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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