

Draft rules to determine FMV of inventory to compute business income in case of its conversion into capital asset – Released

May 8, 2018

In brief

The Central Government has recently issued draft rules¹ to determine the fair market value (FMV) of inventory to compute business income arising on conversion of inventory into capital asset for the purpose of section 28(via) of the Income-tax Act, 1961 (the Act), as introduced *vide* the Finance Act, 2018. The Central Board of Direct Taxes (CBDT) has invited comments/ suggestions on the draft notification from stakeholders by 14 May, 2018.

In detail

Background

- Under the Act, the conversion of capital asset into stock-in-trade is taxable as capital gains. However, the existing provisions does not cover the situations of conversion of stock-in-trade to capital asset. To bring parity and to discourage the practice of deferment of tax payment on conversion of inventory into capital asset, the Finance Act, 2018 was amended.
- The Finance Act, 2018 has provided as follows:

- FMV of inventory on the date of conversion to be taxed as business income [section 28(via) and section 2(24)(xiia) of the Act];
- Such FMV to be considered as cost of acquisition (COA) for computing capital gains on transfer of converted capital asset [section 49(9) of the Act];
- Period of holding of converted capital asset to be reckoned from the date of conversion thereof [sub-clause (ba) to clause (i) of Explanation 1 to section 2(42A) of the Act]; and
- Such FMV to be considered as actual cost for the purpose of claiming depreciation thereof, where the converted capital asset is being used for the purpose of business or profession [Explanation 1A to section 43(1) of the Act].
- Since the FMV should be determined in the prescribed manner as per the aforesaid provisions, the Central Government has issued the following draft rules.

Draft valuation rules

Nature of inventory	Proposed valuation methodology	Comments
Immovable property, being	Stamp duty valuation as on the	The method prescribed is same

¹ Issued via a Press Release dated 3 May, 2018

Nature of inventory	Proposed valuation methodology	Comments
land, or building or both	date of conversion/ treatment as capital asset	as prescribed for the purpose of sections 50C/ 56(2)(x) of the Act
Jewellery, archaeological collections, drawings, paintings, sculptures, any work of art, shares or securities referred to in rule 11UA of the Income-tax Rule, 1962	According to the manner as prescribed in sub-rule (1) of rule 11UA of the Rules with valuation date being the date of conversion/ treatment as capital asset	The method prescribed is same as prescribed for the purpose of sections 50CA/ 56(2)(x) of the Act
Any other property	The price that such property would ordinarily fetch on sale in the open market as on the date of conversion/ treatment as capital asset	–

The takeaways

The rules are proposed to be effective from 01 April, 2019 and applicable from assessment year 2019–20. *Prima facie*, the rules seem to be applicable

retrospectively to transactions entered into after 01 April, 2018, but before the notification of the final rules. CBDT may provide clarity in this regard once the final rules are notified.

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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