



Tax Insights

30 May 2023

Changes in angel tax provisions – specified class of investors and start-up companies exempt; draft valuation rules open for public comments

In brief

Section 56(2)(viib) of the Income-tax Act, 1961 (the Act) provides for taxing excess of the aggregate consideration received by specified companies from the resident investors over the fair market value of shares, if such consideration received exceeded the face value of the shares. Through the Finance Act, 2023, this section has been amended to include the consideration received from non-resident investors as well.

The Central Board of Direct Taxes (CBDT) issued a press release¹ proposing changes to rule 11UA of the Income-tax Rules, 1962 (Rules) for the valuation of shares for the purpose of section 56(2)(viib) of the Act. In the press release, CBDT also proposed to exclude certain classes of non-resident investors and companies, to be notified, from the applicability of section 56(2)(viib) of the Act.

In continuation of the above, CBDT issued Notification No. 29² providing for the class of investors excluded from the applicability of section 56(2)(viib) of the Act.

Moreover, the Central Government issued Notification No. 30³ providing that section 56(2)(viib) of the Act will not be applicable to 'startups' covered under para 4 of the Department for Promotion of Industry and Internal Trade (DPIIT) Notification⁴ dated 19 February 2019 and which comply with the conditions specified in that para and files the declaration under para 5 and receives consideration for the issue of shares from any person. The notification will be effective from 1 April 2023. In continuation of the above, the CBDT released a communication⁵ with proposed amendments to rule 11UA of the Rules (Draft Rules) which are open to public comments. Suggestions or comments from all the stakeholders and general public are invited to the Draft Rules upto 5 June 2023. The final rules will be effective from the date its published in the official gazette.

In detail

Notification No. 29 – Excluded entities

The first proviso to section 56(2)(viib) of the Act enables the Central Government to notify that the its provisions will not apply to receipt of consideration from a certain class of persons. Pursuant thereto, the Central

¹ [Press Release dated 19 May 2023](#)

² Notification No. 29/2023/F. No. 370142/9/2023-TPL (Part-I) dated 24 May 2023

³ Notification No. 30/2023/F. No. 370142/9/2023-TPL (Part-I) dated 24 May 2023

⁴ Notification No. F. No. 5(4)/2018-SI dated 19 May 2023

⁵ Notification No. F. No. 370142/9/2023-TPL (Part-I) dated

Government has notified the following classes of persons (Press release mentioned 'being non-resident investors'):

- (i) Government and government-related investors such as central banks, sovereign wealth funds, international or multilateral organisations, or agencies including entities controlled by the government or where direct or indirect ownership of the government is 75% or more;
- (ii) Banks or entities involved in the insurance business where such entities are subject to applicable regulations in the country where they are established or incorporated or a resident;
- (iii) Any of the following entities, which is a resident of any country or specified territory, listed below, and such entity is subject to applicable regulations in the country where it is established or incorporated or is a resident:
 - a) entities registered with the Securities and Exchange Board of India as Category-I Foreign Portfolio Investors;
 - b) endowment funds associated with a university, hospitals or charities;
 - c) pension funds created or established under the law of the foreign country or specified territory;
 - d) broad-based pooled investment vehicle or fund where the number of investors in such vehicle or fund is more than 50 and such fund is not a hedge fund or a fund which employs diverse or complex trading strategies.

List of 21 countries referred to above is as follows:

Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Iceland, Israel, Italy, Japan, Korea, New Zealand, Norway, Russia, Spain, Sweden, the United Kingdom and United States.

Proposed changes in Draft Rule 11UA of the Rules for the purpose of section 56(2)(viib) of the Act

The Draft Rules have proposed the following modifications to rule 11UA of the Rules:

- The existing rule 11UA(2) of the Rules provided that for the purpose of section 56(2)(viib) of the Act, valuation of unquoted equity shares on the valuation date should be determined at the option of the taxpayer either under the discounted cash flow method (DCF) as determined by the merchant banker or under the prescribed formula or method based on the net asset value (NAV).
 - The Draft Rules substitute rule 11UA(2) of the Rules, which proposes that for the purpose of section 56(2)(viib) of the Act, valuation of unquoted equity shares on the valuation date should be at the option of the taxpayer as follows:
 - (i) In case consideration is received from a resident or non-resident:
 - a. DCF; or
 - b. NAV; or
 - c. In case the taxpayer, being a venture capital undertaking, had issued equity shares to the venture capital fund, venture capital company or any specified fund within 90 days of issue of shares to other residents, the price at which shares were issued to such fund etc. subject to the condition that the consideration from other residents should not exceed the aggregate amount received from such fund etc. within such period of 90 days; or
 - d. In case the taxpayer had issued equity shares to any entity notified under section 56(2)(viib)(ii) of the Act within 90 days of issue of share to other residents, the price at which shares were issued to such notified entity subject to the condition that the consideration from the other resident should not exceed the aggregate amount received from such notified entity within such period of 90 days.
 - (ii) In case consideration is received from a non-resident, in addition to the above a, b, c, or d, the value determined by a merchant banker under the following methods:
 - a. Comparable Company Multiple Method

- b. Probability Weighted Expected Return Method
 - c. Option Pricing Method
 - d. Milestone Analysis Method
 - e. Replacement Cost Methods
- Draft Rules propose to insert sub-rule (3) to provide that if the date of the valuation report of the merchant banker is not more than 90 days prior to the date of issue of shares as above, the taxpayer has the option to deem the date of the report to be the valuation date.
 - Draft Rules propose to insert sub-rule (4) to provide a safe harbour of 10% variation in value:
 - a) if consideration is received from residents and valuation is as per NAV or DFC methods; and
 - b) if consideration is received from non-residents, and valuation is as per NAV, DCF or any of the five additional methods prescribed for non-residents.

The takeaways

The exclusions to a certain class of investors from the provisions of section 56(2)(viib) of the Act are a welcome move. However, Category I Foreign Portfolio Investors, endowment funds, pension funds and broad-based funds established or incorporated in or resident of certain important jurisdictions like Singapore, UAE, Mauritius, certain European countries like Ireland, Netherland, etc. from which investments are typically made, are not included in the exemption.

Once the Draft Rules are notified, the non-resident investors may have more options to value their investment for the purpose of section 56(2)(viib) of the Act. A safe harbour of 10% also is a welcome move.

It is important to note that section 56(2)(viib) of the Act is applicable to the consideration received from non-residents on or after 1 April 2023. However, Notification No. 29 of the Rules was issued on 24 May 2023, and the Draft Rules will be effective as and when published.

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