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TAX FLASH NEWS

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CBDT issues a notification prescribing the method for valuation of unquoted shares for the purposes of Section 56(2)(x) and Section 50CA of the Income-tax Act

Background

The Finance Act, 2017 introduced clause (x) in Section 56(2) of the Income-tax Act, 1961 (the Act) so as to widen the scope of taxability of receipt of sum of money or property without/inadequate consideration. Under the said clause read with Rule 11UA of the Income-tax Rules, 1962 (the Rules), if a person receives shares and securities or jewellery or artistic work for no/inadequate consideration, the Fair Market Value (FMV) of the same is taken into account for computing taxable income. Similarly, for immovable property, the stamp duty value is taken into consideration for determining taxability. However, when these assets are received as underlying assets of unquoted equity shares of a company, the book value (and not the FMV/stamp duty value) is taken into consideration for determining the value of such shares.

The Finance Act, 2017 introduced Section 50CA with effect from Assessment Year 2018-19 to provide that where consideration for transfer of unquoted shares of a company is less than the FMV of such shares determined in accordance with the prescribed manner, the FMV shall be deemed to be the full value of consideration for the purposes of computing income under the head ‘capital gains’.

On 5 May 2017, the Central Board of Direct Taxes (CBDT) issued a press release[1] along with a draft notification[1] relating to valuation of unquoted shares for the purposes of Section 56(2)(x) and Section 50CA of the Act. It was proposed to amend the rules to prescribe the method of valuation of unquoted shares for the purpose of these sections by taking into account the FMV of jewellery, artistic work, shares and securities and stamp duty value in case of immovable property and book value for the rest of the assets.

[1] Source - www.incometaxindia.gov.in

CBDT Notification

On 12 July 2017, CBDT has issued a notification[2] in exercise of the powers conferred by Section 50CA and Section 56 read with Section 295 of the Act. The proposed amendment with respect to valuation of unquoted shares is summarised as follows:

- The FMV of unquoted equity shares shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner, namely:

  The fair market value of unquoted equity shares = (A+B+C+D - L) × (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 which does not represent the value of any asset;
  - B = the price which 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 = fair market value of shares and securities as determined in the manner provided in this rule;

[2] Notification No. 61 /2017/F. No. 149/136/2014-TPL

- 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:
  - the paid-up capital in respect of equity shares;
  - 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;
  - reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
  - 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;
  - any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
  - any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;
- PV= the paid up value of such equity shares
- PE = total amount of paid up equity share capital as shown in the balance-sheet;

- For the purposes of Section 50CA, the FMV of the share of a company other than a quoted share, shall be determined in the manner provided in sub-clause (b) or sub-clause (c), of clause (c) of Rule 11UA(1) of the Rules. For this purpose the reference to valuation date in the rule 11U and rule 11UA shall mean the date on which the capital asset, being share of a company other than a quoted share, referred to in Section 50CA, is transferred.

Our comments

The final rules are in line with the draft rules issued earlier in May 2017 with minor changes. There has been an amendment for inclusion/exclusion of proposed dividend in/from liabilities amount while computing value of unquoted shares. Further in the draft rules, valuation of unquoted shares (equity or preference) for Section 50CA was to be determined based on valuation methodology prescribed for valuing unquoted equity share under Section 56 of the Act. The final notification has now provided that valuation of unquoted shares (equity or preference) for Section 50CA shall be determined based on valuation methodology prescribed for valuing unquoted equity share or other than unquoted equity shares (as the case may be) under Section 56 of the Act. Accordingly, as per draft rules for Section 50CA, preference shares were to be valued as per book value method prescribed for unquoted equity shares which has now been amended to provide that preference shares will be valued as per fair value based on a valuation report and the same is aligned and in line with existing Section 56 of the Act.

The Rules do not address some of the concerns raised by the stakeholders for e.g. no exception for small value transactions or small shareholders, etc.

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