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TAX FLASH NEWS

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CBDT issues press release and draft notification prescribing the method for valuation of unquoted equity 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 new Section 50CA in the Act with effect from 1 April 2018 to provide that where consideration for transfer of unquoted equity 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'.

CBDT press release

On 5 May 2017, the Central Board of Direct Taxes (CBDT) has issued a press release1 along with draft notification relating to valuation of unquoted equity shares for the purposes of Section 56 and Section 50CA of the Act. It is proposed to amend the rules to prescribe the method of valuation of unquoted equity shares for the purpose of Section 56(2)(x) and Section 50CA of the Act 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.

CBDT draft notification

CBDT has issued draft notification[1] in exercise of the powers conferred by Section 50CA and Section 56(2) read with Section 295 of the Act. The draft notification takes into account FMV/stamp duty value of assets which are received as underlying assets of unquoted equity shares of a company. In view of the said notification, the government proposes to substitute Rule 11UA(1)(c)(b)[2] of the Rules. 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 FMV 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

[1] Source - www.incometaxindia.gov.in
[2] Rules for determination of fair market value

immovable property) 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;

- 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, 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;
  - 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;

- PE = total amount of paid up equity share capital as shown in the balance sheet;

- PV= the paid up value of such equity shares

- For the purpose of Section 50CA of the Act, the FMV of the share, not being a quoted share, shall be determined in the manner provided in sub-clause (b) of clause (c) of Rule 11UA(1) of the Rules.

CBDT has invited comments/suggestions from the stakeholders on the draft notification by 19 May 2017[3].

Our comments

The Finance Act 2017 introduced Section 50CA in the Act which proposes FMV as deemed consideration for transfer of unquoted shares. The draft rules were much awaited as the provision is effective from 1 April 2017. It is proposed to provide the same valuation rules for the purpose of provisions of Section 56(2)(x) which deal with taxation of receipt of property for inadequate consideration. Since the same valuation methodology has been prescribed for both Section 50CA and Section 56(2)(x), it has provided much needed parity of principle of valuation. The draft rules prescribe valuation methodology which is quite pragmatic as it proposes to use the book value of operating assets, fair value of jewellery and stamp duty value of immovable property. As regards the shares of a company, the methodology prescribed under the rules needs to be applied.

The proposed rules would have an impact on the valuation of unquoted equity shares of investment holding companies wherein its downstream investments would now need to be valued applying the proposed valuation approach as against valued at cost currently. The similar impact would be there on mere property holding companies where the stamp duty value of the property would be considered now. This is a welcome move by CBDT as it would curtail the practice of transferring shares of companies at nominal value, which holds assets whose underlying value is far higher than the carrying value.

[3] Comments/suggestions to be sent at the email address dirtpl2@nic.in

www.kpmg.com/in

Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri
Vadodara 390 007
Tel: +91 0265 235 1085/232 2607/232 2672

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