



Tax Flash News

27 September 2023

CBDT notifies the final Rule 11UA relating to amended angel tax provisions and introduces a valuation mechanism for Compulsorily Convertible Preference Shares

Executive summary

In light of representations made by various stakeholders raising their concerns that non-resident investors may face undue hardship in matters related to the valuation of shares, the Central Board of Direct Taxes (CBDT) had issued a draft notification¹ proposing an amendment in Rule 11UA.

CBDT has now notified the amendments in Rule 11UA in exercise of powers conferred by sub-clause (i) of clause (a) of the Explanation to clause (viib) of sub-section (2) of Section 56 read with section 295 of Income-tax Act, 1961.²

In a welcome move, CBDT has separately introduced the mechanism for determining the FMV of Compulsorily Convertible Preference Shares (CCPS) with respect to investments made by residents as well as non-residents in the final notification (including extending the price matching benefit as well as safe harbour benefit to CCPS and providing for adoption of FMV of unquoted equity shares as FMV of CCPS).

The other key changes in final notification vis-à-vis the draft notification are hereunder:

- The final notification has extended the price matching benefit to a Company by providing a 90-day window pre and post the date of issue of shares to a Venture Capital Fund (VCF) or a Venture Capital Company (VCC) or a specified fund or a notified entity.

- The requirement to determine the FMV as on the "valuation date" prescribed under the Rules shall not apply if the safe harbour benefit is opted by the Company.

Key features of the notification amending Rule 11UA

- On issuance of unquoted shares to non-residents, in addition to NAV and DCF methods (currently available to residents), five additional methods are prescribed for the valuation of unquoted equity shares and CCPS to be determined by a merchant banker:
 - Comparable Company Multiple Method
 - Probability Weighted Expected Return Method
 - Option Pricing Method
 - Milestone Analysis Method
 - Replacement Cost Methods
- Price matching benefit:
 - Where any consideration is received by a Venture Capital Undertaking (VCU) for the issue of unquoted equity shares to a Venture Capital Fund (VCF) or a Venture Capital Company (VCC) or a specified fund, the price of the equity shares corresponding to such consideration may, at the option of VCU, be taken as the FMV of the equity shares for other resident and non-resident investors, subject to below conditions:

¹ F.No. 370142/9/2023-TPL(Part-I), dated 26 May 2023. Refer our earlier flash news on draft notification - [CBDT issues draft notification with proposed changes to Rule 11UA relating to amended angel tax provisions and notifies entities eligible for exemption from angel tax provisions \(kpmg.com\)](#)

² Notification no 81 / 2023 / F. No. 370142/9/2023-TPL Part (1), dated 25 September 2023

- the consideration from such other resident and / or non-resident investor does not exceed the aggregate consideration that is received from a VCF or a VCC or a specified fund; and
 - the consideration has been received by the undertaking from the VCF or a VCC or a specified fund within a period of 90 days before or after the date of issue of shares which are the subject matter of valuation.
- Similar price matching benefit would be available if the issuer Company has received any consideration for the issue of unquoted equity shares from any entity notified under clause (ii) of the first proviso to Section 56(2)(viib)³ (the issuance of shares to whom are exempted from Angel Tax provisions), within a period of 90 days before or after the date of issue of shares which are the subject matter of valuation.
- Valuation mechanism for CCPS introduced:
 - FMV to be determined by a merchant banker as per the discounted free cash flow method or based on the FMV of unquoted equity shares determined as per prescribed valuation methods in case of investment by residents as well as non-residents
 - Price matching benefit as provided above shall be applicable even in case of investment in CCPS by resident as well as non-residents.
 - Safe harbour introduced:
 - For timing of valuation: Where the date of valuation report by the merchant banker is not more than ninety days prior to the date of issue of unquoted equity shares which are the subject matter of valuation, such date may, at the option of the assessee, be deemed to be the valuation date. The definition of valuation date under Rule 11U(j) shall not be applicable.
- For the amount of fair valuation: The issue price shall be deemed as the FMV of such unquoted equity shares or CCPS if the variation between the issue price and price determined with the methods provided under this rule is not more than 10 per cent (excluding cases where price matching benefit has been obtained).
- The rules shall come into force from the date of publication of the notification in the Official Gazette.

Our comments

The inclusion of separate valuation mechanism for CCPS, access to variety of valuation of methodologies for CCPS valuation in case of investment by non-residents and flexibility to adopt the FMV of unquoted equity shares is a welcome move. However, no clarity has been provided on valuation of preference shares other than CCPS, the valuation of which may continue to be done basis the open market value principle. The relaxation on the time horizon provided for price matching benefit will increase the ambit of share issuances on which price matching benefit can be availed by the Company.



³ Notification No. 29/2023/F. No. 370142/9/2023-TPL (Part-I), dated 24 May 2023

KPMG in India addresses:

Ahmedabad

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

Bengaluru

Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh

SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai

KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram

Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad

Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2, Serilingampally
Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur

Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi

Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytila, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata

Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai

2nd Floor, Block T2 (B Wing),
Lodha Excellus, Apollo Mills Compound, N M
Joshi Marg, Mahalaxmi, Mumbai- 400011
Tel: +91 22 3989 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara

Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada

Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000

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