



# Tax Flash News



26 April 2024

**KPMG. Make the Difference.**

## Safe harbour rule for the angel tax provisions is curative in nature; applies retrospectively

### Executive summary



The Income-tax law provides for the taxation of a closely held company<sup>1</sup> for the issue of shares at a premium where the issue price is more than the fair market value (FMV) computed in the prescribed manner.

The valuation rules for this purpose were amended in 2023 by introducing a safe harbour limit of 10 per cent.

The Delhi bench of the Tribunal in the case of *Sakshi Fincap Private Limited*<sup>2</sup> held that the amendment is a curative amendment and thus, will apply retrospectively i.e., even with respect to the shares issued prior to the amendment.

The Tribunal, applying the safe harbour rule, deleted the addition made by the tax officer on account of the difference between the issue price of shares and the FMV adopted by the tax officer.

<sup>1</sup> A closely held company is a company in which the public are not substantially interested as defined in section 2(18) of the Income-tax Act.

<sup>2</sup> *Sakshi Fincap Pvt. Ltd. v. ITO* (ITA No. 8389/Del/2019) - Source: Taxsutra

## Background



Section 56(2)(viib) of the Income-tax Act, 1961 (the Act) provides that where a closely held company issues its shares at a premium and the issue price exceeds the FMV of such shares, then the excess consideration is taxable in the hands of the company as an 'income from other sources'.

In this regard, Rule 11UA of the Income-tax Rules, 1962 prescribes the valuation rules for determining the FMV of the equity shares.

In September 2023, the CBDT<sup>3</sup> issued a notification<sup>4</sup> amending Rule 11UA which, *inter alia*, introduced a safe harbour limit of 10 per cent i.e., if the difference between the issue price and the FMV determined under Rule 11UA is not more than 10 per cent, the issue price of equity share shall be deemed as its FMV and thus, no addition can be made under section 56(2)(viib).

There has been an issue with respect to the applicability of the amended rules to the earlier years.

## Facts of the case



During the financial year 2014-15, the taxpayer, a closely held company, issued equity shares and received consideration at the rate of INR15 per share (the issue price).

The tax officer computed the FMV of the share at INR14.68 per share and added the difference between the issue price and the FMV in the taxable income of the taxpayer (i.e., difference multiplied by the number of shares issued).

<sup>3</sup> Central Board of Direct Taxes

<sup>4</sup> CBDT Notification 81/2023, dated 25 September 2023

## Tribunal's decision



The Tribunal deleted the addition made by the tax officer based on the following grounds:

- The difference between the issue price and the value adopted by the tax officer was 2.21 per cent. No addition was required under section 56(2)(viib) for such a minuscule difference.
- Further, the amendment to Rule 11UA was introduced to mitigate the hardship faced by the companies from the unintended invocation of section 56(2)(viib), and therefore, it was a curative amendment.
- It is settled law that the curative amendment is to be applied retrospectively<sup>5</sup>.
- Thus, the safe harbour rules were applicable to the shares issued in the financial year 2014-15 as well.
- As the difference between the issue price and the FMV was less than the safe harbour limit of 10 per cent, no addition can be made under section 56(2)(viib).

<sup>5</sup> *Allied Motors Private Ltd. v. CIT* [1997] 224 ITR 677 (SC)

## Our comments



The introduction of the safe harbour rule had provided the much-needed relief to start-ups by having the flexibility to accommodate a variation up to 10 per cent in the issue price vis-à-vis the FMV arising because of commercial reasons. There were uncertainties whether the safe harbour rule will apply to the pending cases. In the instant decision, the Tribunal has adopted a positive approach and applied the safe harbour rule to the earlier years as well.

The safe harbour rule was also introduced with respect to compulsorily convertible preference shares (CCPS) and this decision should be applicable to the cases involving the valuation of CCPS.

Similar decisions have been rendered in the context of the safe harbour rule for the purposes of section 50C of the Act which deems the stamp duty value to be the full value of consideration for the transfer of land and/ or building if the latter is less than the former.

# 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

## 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

## 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

## Bengaluru

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

## Jaipur

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

## 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

## Chandigarh

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

## Kochi

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

## Chennai

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

## 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

## 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

## Gurugram

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

[kpmg.com/in](https://www.kpmg.com/in)

Follow us on:

[kpmg.com/in/socialmedia](https://www.kpmg.com/in/socialmedia)



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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

© 2024 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

This document is meant for e-communication only.