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**Central Board of Direct Taxes (CBDT) issues draft Rules for manner of determining fair market value (FMV) and reporting requirement for Indian concern on indirect transfer**

24 May 2016

**Background:**

Under section 9(1)(i) of the Income-Tax Act, 1961 (Act), if any share of or interest in a foreign company or entity derives its value *substantially* from assets located in India, then such share or interest is deemed to be situated in India. Accordingly, any income arising from the transfer of such share or interest is deemed to accrue or arise in India and is taxable in India. The share or interest is said to derive its value substantially from assets located in India, if the FMV of assets located in India comprises at least 50 per cent of the FMV of total assets of the company or entity.

The law further provided that the manner of computing the FMV of Indian and global assets would be prescribed in the Rules. The draft Rules (Rules) released by CBDT yesterday lay down the manner of determination of such FMV. The Rules also provide for maintaining of relevant information

by the Indian entity through or in which the foreign entity holds assets in India and the manner of submitting such information to the tax authorities. Stakeholders and general public have been requested to send their comments and suggestions on the Rules by 29 May 2016.

The highlights of the Rules are as below:

**Valuation of Indian assets**

**(a) Being shares of a listed Indian company (where such shareholding does not confer management or control rights in the Indian company)**

The FMV of the shares will be the observable price of the share on the stock exchange. The term "Observable price" is defined to mean higher of (a) average of weekly high and low of closing prices of the shares quoted on the stock exchange during 6-

month period preceding the specified date<sup>1</sup>; (b) average of weekly high and low of closing prices of the shares quoted on the stock exchange during two weeks preceding the specified date.

**(b) Being shares of a listed Indian company (where such shareholding confers management or control rights in the Indian company)**

In such cases, the FMV will be based on the following formula:

$$(A+B)/C$$

Where:

A = market capitalisation of the Indian company on basis of observable price of its shares quoted on recognised stock exchange which records the highest volume of trading during the period considered for determining the price,

B = book value of liabilities of the Indian company as on the specified date, and

C = total number of outstanding shares

The term “book value of liabilities” is defined to mean value of liabilities as shown in balance sheet of the company/entity, excluding paid up capital in respect of equity shares/member’s interest.

The term “Balance sheet” in relation to Indian company is defined to mean (a) Audited balance sheet (including annexed notes) as on specified date, where available; or (b) Balance sheet (including annexed notes) as approved and adopted in the annual general meeting as on the date immediately preceding the specified date.

**(c) Being shares of an unlisted Indian company**

In such cases, the FMV will be the sum of:

- i. The FMV as on the specified date as determined by a merchant banker/accountant in accordance

<sup>1</sup> Specified date is defined under section 9(1)(i) of the Act to mean (i) date on which accounting period of the entity ends preceding the date of transfer of a share or an interest; or (ii) date of transfer, if the book value of the assets of the entity on

with internationally accepted pricing methodology for valuing shares on arm’s length basis, and

- ii. The value of liabilities, if any, taken into account for such FMV determination.

**(d) Being interest in a partnership firm (Firm)/limited liability partnership(LLP)/association of person (AOP)**

In such cases, the FMV will be the sum of:

- i. The proportional enterprise value of such firm/LLP/AOP as on specified date as determined by a merchant banker/ accountant in accordance with internationally accepted pricing methodology, and
- ii. The value of liabilities, if any, taken into account for such FMV determination.

**(e) Other assets**

The FMV will be the sum of:

- i. Price estimated to be fetched if the asset sold in open market on specified date as determined by a merchant banker/accountant, and
- ii. The value of liabilities, if any, taken into account for such estimation.

**Valuation of Global assets<sup>2</sup>**

**(a) Where transfer of share/interest in foreign company/entity is between unrelated parties (who are not associated persons) and the consideration is determined based on a valuation report of an accountant/ merchant banker**

The FMV will be the sum of:

- i. FMV determined in such report; and
- ii. Aggregate amount of liabilities, if any, taken into account for such FMV determination.

the date of transfer exceeds the book value of the assets as on the date referred to in (i) above by 15%

<sup>2</sup> Rate of exchange for converting foreign currency valuation into Indian currency is telegraphic transfer buying rate of such currency as on specified date

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**(b) Being shares of a listed Foreign company/entity in cases not falling under (a) above**

The FMV will be the sum of:

- i. Market capitalisation of the Foreign company/entity computed on basis of observable price of its shares quoted on such stock exchange which records the highest volume of trading during the period considered for determining the price, and
- ii. Book value of liabilities of the Foreign company/entity as on specified date

**(c) Being shares of an unlisted Foreign company/entity in cases not falling under (a) above**

The FMV will be the sum of:

- i. FMV of the foreign company/entity and its subsidiaries on a consolidated basis as determined by a merchant banker/accountant in accordance with internationally accepted pricing methodology, and
- ii. Book value of liabilities of the Foreign company/entity as on specified date

**Determination of income attributable to Indian assets**

The income attributable to assets located in India will be based on the proportion of FMV of assets situated in India as compared to the total FMV of assets of the foreign entity whose shares are transferred.

However, it is provided that where the Transferor fails to provide the relevant information necessary for application of the above formula, the whole of income shall be deemed to be attributable to assets located in India.

The Rules also provide that in cases where substantial assets are located in India, the Transferor shall obtain a report in Form 3CT from an accountant providing the basis of apportionment and certifying that the income attributable to assets located in India is correctly computed.

**Maintenance / furnishing of information relating to indirect transfers**

The Rules also prescribe a list of documents/ information which are required to be maintained and produced by the Indian concern such as:

- Details of holding structure including immediate holding company, intermediate holding company(s) and ultimate holding company;
- Transfer agreement;
- Financial and accounting statements of the foreign entity which directly/indirectly holds assets in India through/in the Indian entity for two prior to the date of transfer;
- Information relating to implementation process of the overall transfer arrangement;
- Information relating to business operation, personnel, finance and properties, valuation report of the foreign entity being transferred and its subsidiaries which directly/indirectly hold assets located in India;
- Evidence to determine place of location of share/interest being transferred such as Asset valuation report;
- Details of taxes paid outside India in relation to transfer of share/interest;
- Valuation report of Indian and Global assets duly certified by a merchant banker/accountant;
- Documents issued in connection with the transactions under the accounting practice followed.

Such information is required to be maintained by the Indian concern for a period of nine years from the end of the financial year in which the transaction resulting in indirect transfer takes place.

The Rules also provide for submission of certain information to the tax authorities in Form 49D.

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