



CBDT notifies Rules for valuing unquoted equity shares

Background

The Finance Act, 2017 inserted a new section 50CA in the Income-tax Act, 1961 (Act) with effect from financial year 2017-18. This provides that in cases where the consideration for transfer of unquoted shares is less than the fair market value (FMV) determined in a prescribed manner, the FMV will be deemed to be the full value of consideration for computing capital gains.

Sections 56(2)(vii) and 56(2)(viii) of the Act provided for taxing receipts of cash or other specified property received by certain persons without consideration or for inadequate consideration. The tax in these cases was to be levied on the basis of the FMV of the property determined under Rule 11UA of the Income-tax Rules, 1962. Under this Rule, the unquoted equity shares of a company were valued based on the book value of its assets and liabilities.

The Finance Act, 2017 also inserted a section 56(2)(x) to widen the rules governing taxability of receipts of cash or other specified property without consideration or for inadequate consideration. Though this provision replaced the provisions of sections 56(2)(vii) and 56(2)(viii) with effect from financial year 2017-18, the valuation norms in Rule 11UA continued to apply.

Rules for valuing unquoted equity shares

In this regard, the Central Board of Direct Taxes had released a draft notification on 5 May 2017 and had invited public comments thereon. Based on the representations received, the final notification which prescribes a modified method for determining the FMV of unquoted equity shares has been released. The methodology prescribed in the final notification is largely similar to that provided in the draft notification with few changes as underlined in the table below. This notification will supersede the existing valuation methodology prescribed for valuing unquoted equity shares under Rule 11UA as well as form the basis for determining the FMV for section 50CA.



The FMV of unquoted equity shares on the valuation date is to be determined in the following manner:

FMV of unquoted equity shares = (A+B+C+D -L) × (PV)/(PE) where,

A	Assets (other than jewellery, artistic work, shares, securities and immovable property)	Book value of all assets <u>in the balance sheet</u> as reduced by: <ul style="list-style-type: none"> • any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any, and • any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset.
B	Jewellery and artistic work	Price it would fetch if sold in the open market on the basis of a valuation report obtained from a registered valuer
C	Shares & securities	Fair value as determined under these rules (based on price prevailing in the stock exchange for quoted shares/securities and value determined under this formula for unquoted equity shares)
D	Immovable property	Stamp Duty Value
L	Liabilities	Book value of liabilities <u>shown in balance sheet</u> but not including the following amounts, namely: <ul style="list-style-type: none"> • the paid-up capital in respect of equity shares; • the amount set apart for payment of dividends on preference shares and equity shares <u>where such dividends have not been declared before the date of transfer at a general body meeting of the company;</u> • 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.

The 'valuation date' for computing capital gains in the hands of transferor would be the date of transfer of shares while valuation date for gift taxation in the hands of transferee is likely to be the date of receipt of shares.

Our Comments

It may be noted that similar valuation norms for unquoted shares were notified in April under section 115TD, which deals with taxation of the 'accreted income' of charitable trusts or institutions in certain cases.

The notified valuation rules (which are effective from 1 April 2017) represents a significant change to the regime governing taxation of income under section 56. Since these deal with notional income, taxation based on underlying value of certain assets (rather than the book value) could lead to a significant increase in the tax cost in several cases.



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