



## **Global Business Tax Alert** Sharp Insights

**CBDT issues final notification<sup>1</sup> amending Rule 11UA in respect of valuation of unquoted equity shares**

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**In this issue:**

[Background](#)  
[Final Notification](#)  
[Conclusion](#)  
[Do you know about Dbriefs?](#)  
[Contacts](#)

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<sup>1</sup>Notification No. 61/2017/F. No. 149/136/2014-TPL

## Background

- Finance Act 2017 introduced additional anti-avoidance measures under the Income-tax Act, 1961 (the 'Act') regarding taxability on transfer of unquoted shares below the fair market value ('FMV') in the form of section 50CA. The said section introduced a deeming fiction where the FMV of unquoted shares is deemed to be its full value of consideration for the purpose of computing income under the head "capital gains" in the hands of the transferor.
- Further, to widen the scope of taxability of receipt of money or property without / inadequate consideration, section 56(2)(vii) (applicable only in case of an individual or HUF) and section 56(2)(viia) of the Act (applicable only in case of a firm or a closely-held company), were replaced by section 56(2)(x). The newly-introduced section applies to all persons in relation to all properties defined therein. The said section brings to tax, the difference between the FMV of the covered property and the actual consideration paid for it, in the hands of the recipient in cases where the difference amount exceeds Rs. 50,000. One of the property covered under the said section is unquoted shares.
- Rule 11UA of the Income-tax Rules, 1962 (the 'Rules') governs the computation of FMV for the purposes of, intra alia, section 56(2)(vii) and 56(2)(viia) of the Act.
- On 5 May, 2017, the CBDT issued a draft notification proposing to amend Rule 11UA in furtherance to newly introduced section 56(2)(x) of the Act. The CBDT further proposed to introduce a new Rule 11UAA to govern the computation of FMV of unquoted shares for the purpose of the newly-inserted section 50CA of the Act. The draft rules were released for public comments.
- Pursuant to the above, the CBDT has now notified<sup>1</sup> final amendments to Rule 11UA and inserted a new Rule 11UAA in relation to Assessment Year 2018-19 and subsequent years.

## Final Notification

### Amendment in Rule 11UA

- The CBDT amended Rule 11UA of the Rules in respect of computation of FMV of unquoted equity shares. As per the amended rule, the FMV of unquoted equity shares shall be determined in the following manner:
- $FMV \text{ of unquoted equity shares } = (A+B+C+D - L) \times (PV)/(PE),$

where,

- Where A is the book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance-sheet as reduced by,
  - i. 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 is 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 is FMV of shares and securities as determined in the manner provided in this rule;

- D is 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 is book value of liabilities shown in the balance sheet, but not including the following amounts, namely:—
  - i. the paid-up capital in respect of equity shares;
  - ii. the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
  - iii. reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
  - iv. 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 book profits in accordance with the law applicable thereto;
  - v. any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
  - vi. any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;
- PV is the paid up value of such equity shares;
- PE is total amount of paid up equity share capital as shown in the balance sheet;

### **New Rule 11UAA**

Rule 11UAA of the Rules provides for determination of value of unquoted shares for the purpose of section 50CA of the Act. As per Rule 11UAA:

- FMV of unquoted equity shares shall be determined in the manner as provided under the amended Rule 11UA as discussed above.
- FMV of unquoted preference shares shall be determined in the manner as provided under Rule 11UA(1)(c)(c) of the Rules. The same is in line with the valuation method prescribed under section 56(2) of the Act.

The Rule further provides that the reference to valuation date in the Rule 11U and Rule 11UA shall mean the date on which unquoted share referred to in section 50CA is transferred.

## **Conclusion**

The final notification is broadly in line to the draft notification issued on 5<sup>th</sup> May, 2017.

While the CBDT has now aligned the valuation of preference shares for the purposes of section 50CA, as per existing valuation rules under Rule 11UA(1)(c)(c), difficulties may arise with respect to valuation of unquoted equity shares in certain cases. For instance, practical difficulties may arise for valuation of equity shares in cases of cross holding, valuing investment in unquoted equity shares of investee companies which in turn hold immovable property/jewelry, etc.

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