

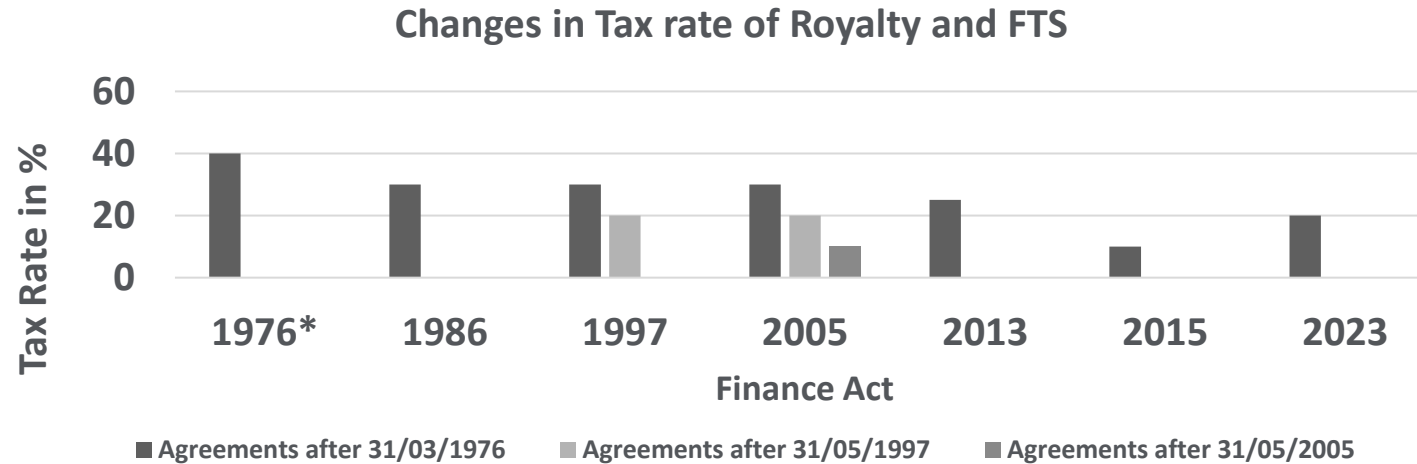


ER&I connect: Tax rate doubling for royalty and fees for technical services, Angel tax and valuation

Increase in Tax rates for Royalty and Fees for Technical Services

Increase in tax rates for Royalty and Fees for Technical Services ('FTS')

Amendment



Law till 31 March 2023

Tax rate for royalty or FTS as per domestic tax law was **10%** (plus applicable surcharge and cess) for cases for non-residents not having a PE in India
[effective tax rate of 10.92%*]

Finance Act, 2023 – Amendment w.e.f 1 April 2023

Tax rate on royalty and fees for technical services income for non-resident taxpayers (no PE cases) has been increased from **10% to 20%** (plus applicable surcharge and cess)
[effective tax rate of 21.84%*]

- A non-resident has an option to opt for tax rates under the domestic law, or treaty, whichever is more beneficial
- However, exemption from filing tax return for non-resident is available for specific income if tax is withheld as per rates under the domestic act

* Assuming highest rate of surcharge

Increase in tax rates for Royalty and Fees for Technical Services

Treaty Rates

Tax rates on royalty / FTS under tax treaty

Particulars	Till 31 March 2023	Amended provisions w.e.f 1 April 2023	Treaty rates <i>Denmark, Italy, etc.</i>	Treaty rates <i>USA, UK, Canada, etc.</i>	Treaty rates <i>Germany, Singapore, Spain, Mauritius, France, Netherlands, etc.</i>	Treaty rates [Make available benefit, MFN Clause]
	10.92%	21.84%	20%	15%	10%	0%
	Domestic law	Domestic law	Treaty	Treaty	Treaty	Treaty
Royalty / FTS income earned by non-residents	100	100	100	100	100	100
Tax rates (%)	10.92	21.84	20	15	10	0
Net Flow	10.92	78.16	80	85	90	100
Tax Cost	10.92	21.84	20	15	10	0



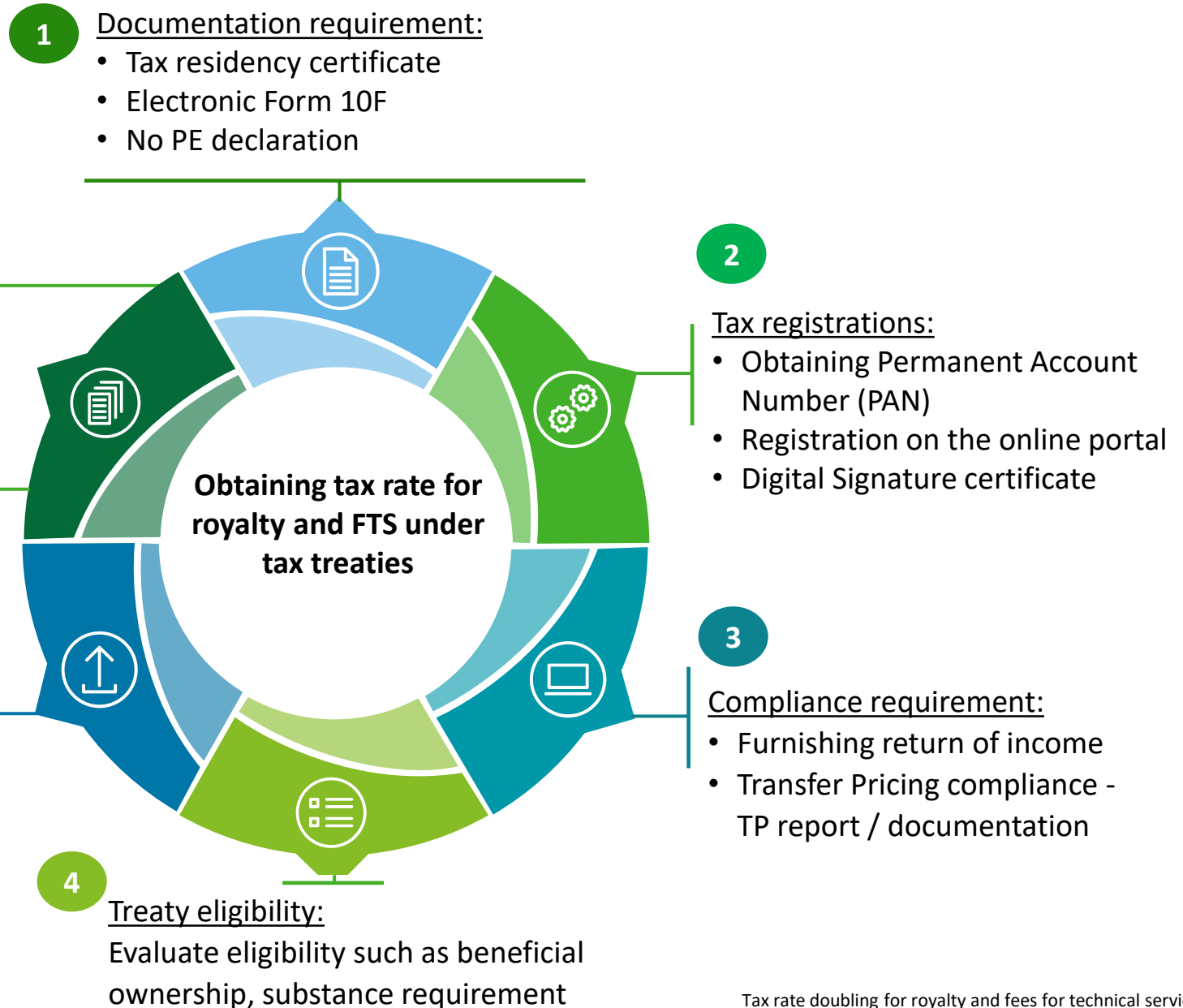
Domestic law rate followed to avoid tax compliance burden



Additional tax cost, or additional compliance burden through treaty benefit

Increase in tax rates for Royalty and Fees for Technical Services

Implications



Polling question 1



To understand the pulse of this change on the industry front, we would like to know if you believe that you or your affiliates will be impacted by this amendment:

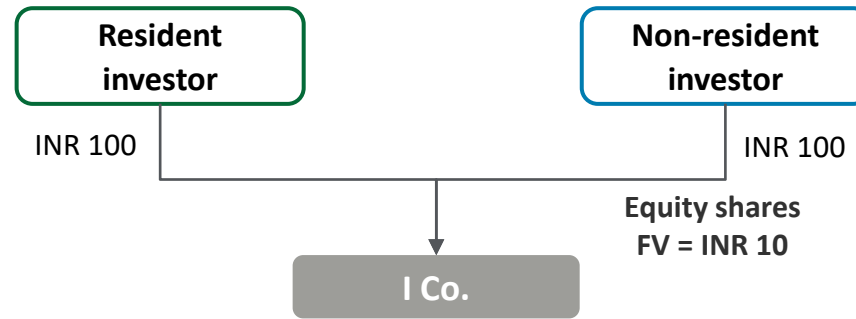
- Our tax compliances have increased
- We are neutral as we were already obtaining tax treaty benefits
- We have not yet evaluated the impact of this amendment



Angel Tax and Valuation

Angel tax and valuation

Premium taxation extended to non-residents - Amendment



Tax implications on issue of shares under Erstwhile provisions

Particulars	Category of investor	
	Resident	Non-resident
Fair Market Value under Rule 11UA [Book Value / DCF at the option of assessee] (a)	90	90
Issue Price by I Co. (b)	100	100
Taxable income in hands of I Co. u/s 56(2)(viib) (b-a)	10	-
Taxability @ 25.17%	3	-

Tax implications on issue of shares under amended provisions

Particulars	Category of investor	
	Resident	Non-resident
Fair Market Value under Rule 11UA [Book Value / DCF at the option of assessee] (a)	90	90
Issue Price by I Co. (b)	100	100
Taxable income in hands of I Co. u/s 56(2)(viib) (b-a)	10	10
Taxability @ 25.17%	3	3

Now extended to non-resident investments

Angel tax and valuation

Relaxation to notified entities

Exemption to certain categories of non-residents

Issuing Company:

- **Startups** notified under Department for Promotion of Industry and Internal Trade

Investors:

- **Government and government related investors** such as central banks, sovereign wealth funds, international or multilateral organizations or agencies including entities controlled by Government
- Banks or Insurance entities
- Following entities if they are residents of 21 notified countries*:
 - SEBI registered Category I FPI
 - Endowment Funds associated with university, hospitals or charities
 - Pension funds
 - Pooled investment vehicle where number of investors exceeds 50 and not a hedge fund

***Notified countries:**

- | | | |
|-------------------|-------------|--------------------|
| 1. Australia | 8. France | 15. New Zealand |
| 2. Austria | 9. Germany | 16. Norway |
| 3. Belgium | 10. Iceland | 17. Russia |
| 4. Canada | 11. Israel | 18. Spain |
| 5. Czech Republic | 12. Italy | 19. Sweden |
| 6. Denmark | 13. Japan | 20. United Kingdom |
| 7. Finland | 14. Korea | 21. United States |

Angel tax and valuation

Specific FMV

FMV of equity shares to be the price at which equity shares issued to a VC Fund/VC Company/Specified Fund OR Specified Investors

Value / Price matching for equity shares issued to a VC Fund/VC Company/Specified fund or Specified Investors :

- FMV - the price at which equity shares issued to aforesaid entities
- Total Consideration - Does not exceed the aggregate consideration received from aforesaid entities
- Time - The consideration is received within a period of 90 days of the issue of shares to aforesaid entities

Example:

If a VC undertaking/issuing-company receives a consideration of INR 50 million from a VC Fund/VC Company/Specified fund or Specified Investors for issue of 1 million shares at the rate of INR 50 per share, then such an undertaking/issuing-company can issue 1 million shares at INR 50 per share to any other investor within a period of 90 days of the receipt of consideration from aforesaid entities.

Angel tax and valuation

Methods

New valuation methods

- Currently, the rule prescribes two valuation methods - namely, Discounted Cash Flow (DCF) or Asset based method **for residents**
- The amended rule proposes below 5 additional valuation methods apart from the aforesaid methods only **for non-residents**
 - Comparable company multiple method
 - Probability weighted expected return method
 - Option pricing method
 - Milestone analysis method
 - Replacement cost method

Valuation Report & Safe Harbor Rule

- Merchant banker valuation report acceptable if the report date is not more than 90 days prior to the date of issue of shares
- Safe harbor of 10% from the fair market value of equity shares on account for forex fluctuations, bidding processes and variations in other economic indicators

Questions

- Convergence with FEMA pricing?
- Date of applicability of notification?
- Convertible instruments?
- Investors covered for new valuation methods?
- Views around valuation methods?
- Use of one or more methods?
- Valuation date ?
- Valuation of unquoted shares and securities other than equity shares?

Thank you!

Kindly spare a minute to help us with your feedback for today's session...

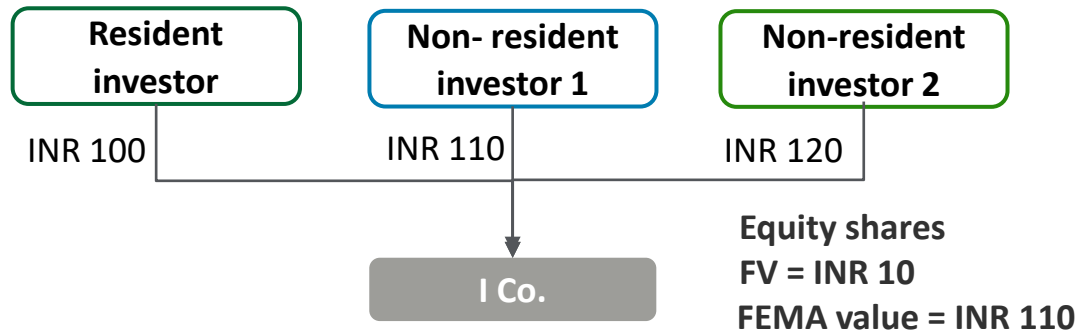
For any queries, please feel free to write to us at intax@deloitte.com

Angel tax and valuation



Convergence of FMV as per Rule 11UA valuation with FEMA valuation

Scenarios :



Particulars	Resident	Non-resident investor 1	Non-resident investor 2
FMV under rule 11UA (a)	90	90	90
Consideration received by I Co.(b)	100	110	120
Taxable income in hands of I Co. u/s 56(2)(viib) (b-a)	10	20	30
Taxability @25.17%	3	5	8

Angel tax and valuation



Convertible equity instruments - Convergence with FEMA Regulations

As per extant FEMA Regulations, (i.e., Foreign Exchange Management (Non-debt Instruments) Rules, 2019), *"In case of convertible equity instruments, the price or conversion formula of the instrument should be determined upfront at the time of issue of the instrument. The price at the time of conversion should not, in any case, be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with these rules."*

Illustration:

FMV at the time of issue – INR 100

FMV at the time of conversion – INR 80

Particulars	At the time of Issue	At the time of Conversion
FMV under rule 11UA (a)	80	100
Deemed issue price	80	80
Taxable income in hands of ABC Pvt Ltd u/s 56(2)(viib) (b-a)	0	20
Taxability @25.17%	0	5

↓
Angel Tax?



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