

DETERMINATION OF FAIR MARKET VALUE (RULE 11UA OF INCOME TAX ACT, 1961)

By CA Adityavikram Banka



INTRODUCTION

- The Income Tax Act emphasizes on the requirement of 'Fair Market Value' in numerous provisions.
- Rule 11UA / 11UAA prescribes valuation methodology for arriving at FMV of immovable property, jewellery, work of art, shares & securities – both quoted and unquoted, for the purposes of anti-abuse provision contained in Sec. 56(2)(viib), 56(2)(x) & 50CA of Income Tax Act.

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METHODOLOGY FOR ARRIVING AT FMV

A) Valuation of Jewellery : The FMV of Jewellery shall be as per report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date.

B) Valuation of Archaeological Collections, Drawings, Paintings, Sculptures Or Any Work Of Art : The FMV of Work Of Art etc. shall be as per report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date.

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C) Valuation of Shares and Securities for Sec 56(2)(x) & 50CA of Income Tax Act :

FMV of Shares & Securities under Sec 56(2)(x) & 50CA of Income Tax Act for sale / transfer/ receipt of Shares & Securities without or for a consideration which is less than the FMV will be as below :

1. Quoted Shares and Securities : The FMV of Quoted Shares and Securities shall be lowest price of such shares and securities quoted on any recognized stock exchange on the valuation date.

2. Unquoted Equity Shares: The FMV of Unquoted Equity Shares shall be as below :

FMV of unquoted equity shares = $(A + B + C + D - L) \times (PV)/(PE)$

3. Unquoted Shares and Securities other than Equity Shares: The FMV of Unquoted Shares and Securities other than Equity Shares shall be as per report of from a Merchant Banker or an Accountant in respect of such valuation.

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$$\text{FMV of unquoted equity shares} = (A + B + C + D - L) \times (PV)/(PE)$$

where,

A = Book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance sheet;

B = 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 = Fair market value of shares and securities as determined in the manner provided in this rule;

D = 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 = Book value of liabilities shown in the balance sheet;

PV = The paid-up value of such equity shares;

PE = Total amount of paid-up equity share capital as shown in the balance sheet

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D) Valuation of Shares and Securities for Sec 56(2)(viib) of Income Tax Act : FMV of Shares & Securities under Sec 56(2)(viib) of Income Tax Act in case of fresh issuance of shares will be as below :

1. Quoted Shares and Securities : The FMV of Quoted Shares and Securities shall be lowest price of such shares and securities quoted on any recognized stock exchange on the valuation date.

2. Unquoted Equity Shares: The FMV of Unquoted Equity Shares shall be as per any of the bellow method at the option of the assessee :

i) NAV Method : FMV of Unquoted Equity Shares = $(A-L) \times [PV/PE]$; or

ii) DCF Method : FMV of Unquoted Equity Shares shall be as per report of from a Merchant Banker as per the Discounted Free Cash Flow method; or

iii) Price Matching Method : In case of shares issued to AIFs / VC fund / VC companies / notified entities, FMV of Unquoted Equity Shares shall be price at which the unquoted equity shares have been issued to these entities can be taken as FMV.

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Additional option in case of issue of equity shares to a Non-Resident

FMV of Unquoted Equity Shares shall be as per report of from a Merchant Banker in accordance with any of the following methods :

- a. Comparable Company Multiple Method;
- b. Probability Weighted Expected Return Method;
- c. Option Pricing Method;
- d. Milestone Analysis Method;
- e. Replacement Cost Methods;

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3. Unquoted Compulsorily Convertible Preference Shares (CCPS) : The FMV of Compulsorily Convertible Preference Shares shall be as per any of the bellow method at the option of the assessee :

i) Where issued to Resident:

- Valuation of CCPS in question using either DCF or Price Matching Method; or
- Valuation of the equity shares of the issuer using NAV, DCF or Price Matching

ii) Where issued to Non Resident:

- Valuation of CCPS in question using any method except NAV
- Valuation of the equity shares of the issuer using any method

4. Unquoted Shares and Securities other than Equity Shares & Compulsorily Convertible Preference Shares (CCPS): The FMV of Unquoted Shares and Securities other than Equity Shares & Compulsorily Convertible Preference Shares (CCPS) shall be as per report of from a Merchant Banker or an Accountant in respect of such valuation (refer sub clause c of rule 11UA(1)(c)).

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E) Validity of the Valuation : Equity shares and CCPS can be issued by a company on the basis of valuation report which is issued by merchant banker not earlier than 90 days from date of issue of equity shares/CCPS.

F) Safe Harbour Clause for Fresh Issue of Shares:

1. Shares can be issued at a price variation not exceeding 10 % of value where valuation has been done either by NAV method or DCF by a merchant banker where the shares are issued to a resident.

2. Shares can be issued at a price variation not exceeding 10 % of value where valuation has been done either by NAV method or by a merchant banker following any of the 6 methods where the shares are issued to a non resident.

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G) Exemption from FMV u/s 56(2)(x) for receipt of Shares & Securities in case of Merger / Demerger.

H) Practical Difficulties :

1. Company Holding Shares of Another Company : The practical difficulties that one may encounter while determining the FMV of shares & securities (for Sec.56(2)(x) purposes) that while valuing share value of A, where A owns shares of B, B owns shares of C, which in turn owns an immovable property, first the immovable property is to be valued to determine share value of C, required to value shares of B and ultimately shares of A. It is an extremely difficult exercise, further the rule would fail in case of cross holdings.

2. Interplay of Sec.56(2)(viib) and Sec.56(2)(x) : Illustrating with an example, a situation may arise whereby value determined for the purpose of Sec.56(2)(x) using NAV after adjusting value of specified assets may be higher (say 200) than the value determined for the purpose of Sec.56(2)(viib) [without adjusting for the value of specified asset as envisaged in the rule], say 150. This would mean that if the company issued shares at a value more than 150, the company would be liable to tax on the excess and if the shareholder receives a share at a price lower than FMV 200, such shareholder would be liable to tax on the differential.

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I) At Assessee's Option : Mumbai ITAT in case of [TS-608-ITAT-2019(Mum)] held that the method of valuation i.e. NAV method or Discounted Cash Flow (DCF) method to determine the FMV has to be adopted at assessee's option and the AO cannot change the method of valuation opted by the assessee.

J) The difference in method of valuation of Equity Shares u/s 56(2)(viib) and 56(2)(x) as under:

Section	Sec.56(2)(viib)	Sec.56(2)(x)
Applicable Rule	Rule 11UA(2)	Rule 11UA(1)(c)(b)
Transaction	In case of fresh issuance of Equity Shares	Any person receiving the Equity Shares
Method prescribed for computation of FMV	DCF Method or Book value (NAV) calculated without adjusting for specified assets, at the option of the assessee	Book Value calculated after adjusting for specified assets
Valuer	Only Merchant Banker for DCF	Not prescribed
Valuation to be done based on -	Balance sheet drawn on the valuation or the last drawn balance sheet which is approved at the AGM by the shareholders	Balance sheet drawn up on the valuation date, duly audited by the auditor of the company
Exemption	In case of issue of shares to venture capital company or a venture capital fund or a specified fund or notified entities	Receipt of shares in case of merger or demerger

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THANK YOU

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