Valuations under Rules 11UA/ 11UB/ 11UAE of Income-tax Rules, 1962

National Conference on Valuation Standards
Organized by Valuation Standards Board, ICAI
Hosted by Pune Branch of WIRC of ICAI

Background

One of the fundamental principles of taxation is that income may be realized in cash or in kind. If it is in the form of money, then there is no difficulty in ascertaining the income. However, when it is in the form of money's worth, i.e. an asset, then a fair market valuation of the asset received must be carried out to work out the income for levying Income Tax **[Raja Mohan raja Bahadur; Orient Trading Co Ltd vs CIT]**

Within the framework of the Income-tax Law, numerous provisions mandate the requirement for valuation. To offer clarity and direction in conducting such valuations, the law has established specific rules.

Rules 11UA/ 11UB/ 11UAE are amongst such prescribed rules. The pertinent sections of the act that stipulate these rules and delineate the necessity for valuation under these specific rules are outlined as follows:

Rule	Relevant Sections
11UA	Section 56(2)(x), 56(2)(viib), 50CA*
11UB	Section 9(1)(i)
11UAE	Section 50B

**Sec 50CA prescribes rule 11UAA and Rule 11UAA refers to Rule 11UA(1)(c)*

Rule 11UA , 11UB, 11UAE of Income-tax Rules

Genesis of Rule 11UA

Section 50CA

- Sec 50CA provides that for computing capital gain at the time of transfer of unquoted shares of company, where consideration received or accruing is less than the FMV of such share, such FMV determined using the prescribed rule, shall be deemed to be the FVOC.
- Thus, sec 50CA determines the minimum full value of consideration on transfer of unquoted shares.

Section 56(2)(viib)

- Section 56(2)(viib) provides that where a company in which public is not substantially interested receives any consideration from any resident person for issue of shares that exceeds the face value of such shares, shall be considered as income if consideration received for such shares is more than the fair market value of the shares.
- Thus, Sec 56(2)(viib) determines Fair Market value of the asset

Section 56(2)(x)(c)

- Clause (c) of sec 56(2)(x) provides that where transfer of property other than an immovable property occurs, and either no consideration is received or the consideration so received is less than the FMV, then such FMV shall be considered as income of the assessee, provided the aggregate FMV of the property exceeds Rs. 50,000/-.
- Sec 56(2)(x) is a deeming provision to bring notional income to tax.

This rule provides a comprehensive framework for determining fair market value across diverse assets, aiming for consistency and transparency in valuation practices for tax purposes.

What does Rule 11UA say?

Rule 11UA outlines the method of determining fair market value for various properties, excluding immovable property.

Valuation of Jewelry and artistic work

- Fair market value is estimated based on the open market price on the valuation date.
- If purchased on the valuation date from a registered dealer, the invoice value is considered fair market value.
- For other modes of acquisition exceeding INR 50,000, a registered valuer's report may be obtained

Valuation of Shares and Securities:

- For quoted shares, fair market value is the transaction value recorded in a recognized stock exchange.
- Unquoted equity shares' fair market value is determined using the formula given in other slide
- Unquoted shares and securities, other than equity, may require a valuation report from a merchant banker or accountant.

Special Provisions:

- Rule 11UA(2) provides alternative methods for determining fair market value of unquoted equity shares, considering considerations from residents or non-residents.
- Various valuation methods, including Discounted Free Cash Flow, Comparable Company Multiple, etc., are provided.
- Rule 11UA(3) allows the valuation report's date to be deemed the valuation date under certain conditions
- Rule 11UA(4) addresses scenarios where the issue price exceeds the determined value, with specific adjustments

Valuation of unquoted Equity Shares u/r 11UA

Fair market value ("FMV") of unquoted equity shares = **(A+B+C+D-L) x PV/PE**, where

A - Book value of all the assets (except those mentioned at B, C and D below) as reduced by income tax paid as advance tax/TDS/TDC (net of refund) and any amount shown in the balance sheet as asset including the unamortized amount of deferred expenditure which does not represent the value of any asset

B - Fair market value of Jewellery and artistic work based on the valuation report of a registered valuer

C - Fair market value of shares or securities as determined according to this rule

D - Stamp duty valuation in respect of any immovable property

L - Book value of liabilities, excluding:

- the paid-up capital in respect of equity shares;
- 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;
- 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 the 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;

PV - Paid-up value of equity shares PE - Total amount of paid-up equity share capital as shown in the balance sheet

Treatment of Cumulative Convertible Preference Shares

Rule 11UA(2) of the rules to be applied for valuation of Compulsory convertible preference shares (CCPS) along with applicability of safe harbor threshold:

- A new clause has been provided to compute the FMV of CCPS on the valuation date as determined in the following manner

Consideration received from resident

(i) As per clause (b) or clause (c) or clause (e) of Rule 11UA of the rules of based on the FMV of unquoted equity shares in accordance with clause (a) or clause(b) or clause (c) or clause (e), at the option of the taxpayer where the consideration received by the taxpayer is from a resident;

Consideration received from non-resident

(ii) As per clause (b), clause (c), clause (d) or clause (e) of rule 11UA of the Rules or based on the FMV of the unquoted equity shares in accordance with clause (a) to clause (e), at the option of the taxpayer, where the consideration received by the taxpayer is from a non-resident.

- The final rules also provide that the safe harbour threshold of 10% under Rule 11UA(4) of the Rules shall also apply in determination of FMV of CCPS. Further, the new rules define the term ‘Issue price’ to mean the consideration received by the company for one share.

Fair value determination methods – Rule 11UA

According to a recent amendment under Rule 11UA, the Merchant Banker has to use the following methods of valuation of unquoted Equity shares, where consideration is received from a non resident

(i) Comparable Company Multiple Method: Utilizes valuation multiples of similar publicly traded companies to assess the value of the target company.

(ii) Probability Weighted Expected Return Method: Estimates the expected return by assigning probabilities to different potential outcomes.

(iii) Option Pricing Method: Applies option pricing models to value the rights associated with certain financial instruments or agreements.

(iv) Milestone Analysis Method: Values intellectual property or intangible assets based on the achievement of specific milestones.

(v) Replacement Cost Methods: Determines the value of an asset by assessing the cost of replacing it with an equivalent.

Genesis of Rule 11UAE

Sec 50B provides that where a slump sale of capital asset has occurred, for determination of capital gain chargeable to tax, the net-worth of the undertaking or division shall be deemed to be the cost while the FMV of the capital assets as on the date of transfer, shall be deemed to be the FVOC.

The FMV is determined using Rule 11UAE.

This rule establishes a structured approach for computing the fair market value of capital assets in the context of slump sales under Section 50B, providing clarity and consistency in valuation practices for tax purposes.

Provisions of Rule 11UAE

Rule 11UAE serves the purpose of determining the fair market value (FMV) of capital assets for Section 50B
The FMV for the capital assets transferred via a slump sale is determined based on two options: FMV1 and FMV2.
The higher value between FMV1 and FMV2 is considered.

FMV1 Calculation:
FMV1 is calculated using the formula: A + B + C + D - L

- A: Book value of assets (excluding certain items) in the books of accounts.
- B: Price of jewellery and artistic work in the open market (valuation report from a registered valuer).
- C: Fair market value of shares and securities (determined as per Rule 11UA).
- D: Value for stamp duty of immovable property.
- L: Book value of liabilities (excluding certain items) in the books of accounts.

FMV2 Calculation:
FMV2 is calculated using the formula: E + F + G + H

- E: Monetary consideration received.
- F: Fair market value of non-monetary consideration represented by property (as per Rule 11UA).
- G: Price of non-monetary consideration represented by property (other than immovable property) in the open market (valuation report from a registered valuer).
- H: Value for stamp duty of immovable property.

Genesis of Rule 11UB

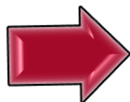
Pursuant to the supreme Court's decision in favor of **Vodafone International Holdings BV,** the Income tax Act was amended with retrospective effect to insert an amendment to sec 2(47) and sec 9(1)(i) of the act. Accordingly, indirect transfers of foreign companies which held shares in Indian entities were also sought to be taxed in India. The transfer of foreign companies is taxable in India if it derives substantial value from Indian assets, i.e., if the FMV of the assets located in India are at least 50% of the value of the assets of the foreign company and such assets > 10 10crores. In order to determine the FMV, the CBDT has prescribed Rule 11UB

Section 9 of the act deals with four main elements –

1. It stipulates that any income accruing or arising where the situs of the property or assets is within India, shall be chargeable to tax. India claims sovereignty over any property or assets situated within its borders, and it is upon this basis that the provision of Section 9 is applied.
2. Incomes derived from a business connection in India shall also be taxable. This section stresses on a source in India, generated by an activity in India, regardless of where the revenue was expended or vested. Business connections can be constituted through various mediums, such as services, property, shares or even rights such as copyright, patents and profits.
3. Section 9 states that any income generated by asset or property located in India shall be subject to taxation in the country. This is applicable to all citizens, foreign entities and other non-residents who are receiving income from assets or properties located in India.
4. It provides for the taxation of incomes from transfer of capital assets situated in India, regardless of its nature or form. It should be noted that this provision only applies to transactions initiated after April 1, 1962.

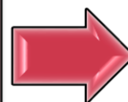
Rule 11UB of the Income Tax Act

Rule 11UB pertains to the determination of the fair market value of assets and apportionment of income in specific cases under the Income Tax Act.

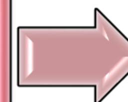


Applies to companies or entities registered outside India ("foreign company or entity") for determining the fair market value of assets:

- For shares of an Indian company listed on a recognized stock exchange, the fair value will be
- (i) Observable price on the stock exchange, or
- (ii) (Market Cap + Liabilities/ Total number of outstanding shares) depending on management or control rights.
  - For unlisted Indian company shares: Merchant banker or accountant's valuation based on internationally accepted methodology.
- For partnership firm or association of persons interest: Valuation by merchant banker or accountant based on accepted methodology.
  - For other assets: Open market sale price determined by merchant banker or accountant.



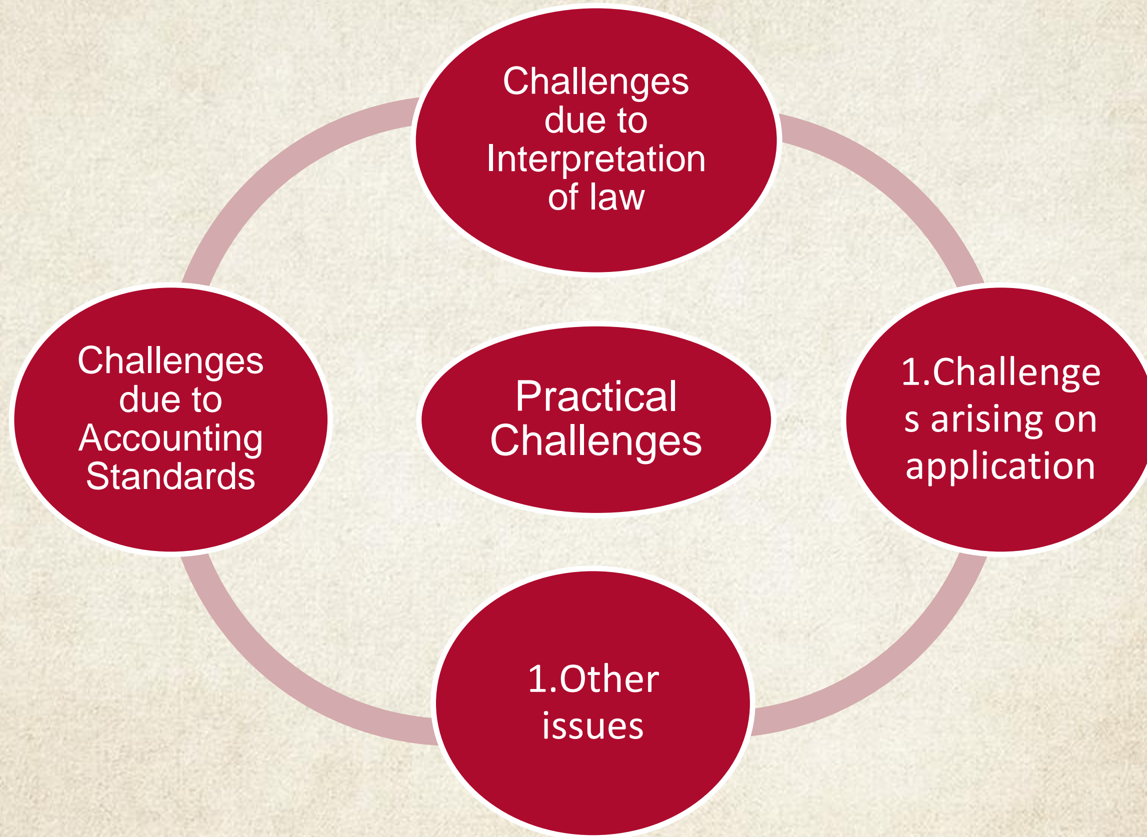
Different formulas have been provided for Foreign Company or Entity for fair market value based on listing status of shares and transfer scenarios.



If fair market value determined based on interim balance sheet, adjustments required after finalization of the relevant financial statement. For Indian company shares or partnership/association interest, consider all assets and business operations globally.

Practical Challenges on Valuation

Despite these rules providing a methodology for computing asset valuation, they present numerous practical and operational challenges encountered by valuation professionals.



1. Challenges due to Accounting Standards

16

Ind AS Challenges – Complex Equity instruments

Growing use of complex capital instruments, such as Optionally Convertible Redeemable Preference Shares (OCPRS), in startups and private equity-backed companies. Unique accounting treatment of bifurcating the equity and liability portions of these instruments has been given under Ind AS 32 and Ind AS 109

The classification under Ind AS should not be automatically applied for assessing liability under rule 11UA(1)(c)(b).

Valuation, using the NAV method, attributes value to equity shareholders based on their rightful entitlements, requiring a detailed analysis of rights and appropriate adjustments.

Rejecting a one-size-fits-all approach, advocating for tailored evaluations based on specific instrument characteristics.

Mandatorily Convertible Debt

Issue: Treatment of **mandatorily convertible debt** as per Indian Accounting standard 109 is to bifurcate the amount in two components as below
Fair value of liability: This is calculated by discounting the interest to present value based on the market interest rate for comparable bonds without conversion rights.
Fair value of equity: The residual value is determined by deducting the fair value of liability from the proceeds raised through the debt instrument.
However, as per Rule 11UA and 11UAE, Liabilities exclude equity share capital, Reserves and surplus, etc. So, we don't have a clarity as to whether the liability portion should form part of the liabilities as per rule or not

Probable views:

1. The liability component can remain unchanged. However, for valuation under rule 11UA, given the "mandatorily convertible" nature, one could consider recalculating the number of equity shares as if the conversion has occurred. These recalculated shares may then be added to the current outstanding equity shares when determining the fair market value per share.
2. Consider the total amount under equity since the same is convertible compulsory

Fixed equity shares against CCPS

The issuance of **fixed equity shares against CCPS** represents a non-derivative contract, entailing the issuance of a predetermined quantity of equity shares, and is classified as equity under Ind AS 109.

Probable views:

1. While determining the equity value under rule 11UA(1)(c)(b), potentially the equity amount can be reclassified as a liability. This adjustment aims to ascertain the value attributed to equity holders, divided by the number of common stocks.

2. Consideration could be given to recalculating the number of equity shares, assuming the conversion has occurred, and incorporating these converted shares into the current outstanding equity shares.

Optionally Convertible Redeemable Preference Shares

The **Optionally Convertible Redeemable Preference Shares** comprises three sub-components:

- **Redeemable principal amount**: Treated as Financial liability under IND AS
- **Discretionary, non-cumulative dividend**: Equity under Ind AS
- **Holder's option to convert into ordinary equity shares**: Equity

Possible view

The equity portion can be reclassified as a liability, along with the other liability components of OCRPS. This reclassification is necessary to determine the value attributed to equity holders. The resulting value is then divided by the number of common stock to ascertain the value per share of equity under rule 11UA(1)(c)(b).

Ordinary shares with redemption rights

The **ordinary shares with redemption rights** encompass two distinct components:

- **Financial liability:** The present value of the redemption amount is categorized as a financial liability.
- **Equity feature:** The residual amount, representing the difference between cash received and the financial liability, is attributed to equity.

Possible view:

The sum designated as a financial liability can be reclassified as equity for the purpose of valuation under rule 11UA(1)(c)(b). This adjustment aligns with the principle that the total amount of paid-up equity share capital in the balance sheet should correspond to the paid-up value of such equity shares.

Perpetual Loan

The **perpetual loan** with mandatory interest comprises two key elements:

- **Financial liability:** This pertains to the mandatory interest payable by the issuer.
- **Equity feature:** The perpetual nature of the principal, which is not obligated for repayment.

Possible view:

1. The whole amount can be treated as a liability since the loan, by its nature remains payable, whether or not it is perpetual

2. Unless the equity is subordinate to the bondholder in a liquidation scenario, the portion classified as equity can be treated as part of reserve and surplus. Consequently, it can be excluded from the calculation of the book value of liabilities.

Derivative Instruments

Derivative instruments like Future, Options, swaps, Market Linked Debentures etc. are recognized through Profit and Loss account at Market value of the instrument according to Ind AS.

- As per “ICDS 8 – Securities” any derivative instrument should be accounted for at cost
- Hence, the derivatives held can be valued at cost while determining NAV of the entity

Interest-free loan from group company

Under Ind AS 32 and Ind AS 109, the interest-free loan undergoes fair value measurement by discounting the loan amount with the market interest rate for similar loans. The resulting fair value is recognized as a liability, while the remaining amount is categorized as other equity. Over time, the loan liability increases through a charge in the profit and loss account.

Possible view:

The portion currently listed under other equity can be reclassified as a liability for NAV calculation under the Rule.

Ind AS Challenge – Leases

As per recently notified **Ind AS 116,**
Operating leases are required to be accounted on balance sheet by recognizing a liability and a corresponding asset.
Operating lease liability is required to be computed as the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate.
An asset is recognized as right-of-use and is depreciated over the useful life of this asset.

Possible views:

1. *Asset-side right-of-use is an intangible asset and hence it is not an immovable property for the purpose of rule 11UA. W.r.t the lease liability, that the same may be treated as a liability for the purpose of the Rule. Hence, operating leases should be accounted for by taking the book value of the lease asset and liability as reported on the balance sheet*
2. *ROU asset can be considered as Immovable property?*

   Due to multiple references under Income tax act to capitalize leased assets and stamp duty requirement for long leases and treatment accordingly as immovable property?

2. Challenges due to Interpretation of law

Tax interpretation Challenges

1. Minimum alternate tax (MAT) credit entitlement

- MAT credit entitlement is appearing as an asset on the balance sheet, then?
- **Possible view:** It can be **considered as an asset** for the purpose of the above valuation Rule because it represents the value of the underlying asset and will be available for offsetting future tax liability
- Shifting to new regime?

2. Income Taxes paid in dispute

- The Rule states that "any amount of income-tax paid, if any, less the amount of income-tax refund claimed if any" should be reduced from the total assets as calculated as per the Rule.
- **Possible view:** This **cannot be considered as an asset** and accordingly reduced from the overall assets. Except when refund has been claimed and under protest

Tax interpretation Challenges

3. Definition of book profits for the Purpose of above Rule

- In computing liabilities under the mentioned Rule, any surplus provision for income tax, exceeding the tax payable on book profits, should be reversed to reduce the liability. However, the Rule does not specify the definition of "book profits" or the applicable income tax rate.
- A possible view to this is that the reference is to **book profits as computed for the purpose of section 115JB** of the IT Act and the income tax rate may be taken by referring to the marginal tax rate for the company

4. Deferred tax assets/ liabilities

- The Rule states, “any amount shown as asset …which does not represent the value of any asset” should be excluded from the assets computed for the purpose of this Rule.
- **Possible views:**

1. DTA is such an asset on balance sheet which does not represent the value of any asset and hence should be **excluded from the assets.**
2. **To not exclude DTA from assets.**

Tax interpretation Challenges

5. Provisions made for employee benefits like compensatory leaves and gratuity

The Rule states that "any amount representing provisions made for meeting liabilities, other than ascertained liabilities" should not be considered as part of liabilities. A question arises: whether provision made for employee benefits like compensatory leaves and gratuity is ascertained or not ascertained?

Such provisions are made **based on some scientific approach** by analysing past data, these provisions **can be considered as ascertained liabilities**. Similarly, in case of product warranties, it is ascertained liability and not contingent liability

Case Studies Supporting the above view:

a. ***Bharat Earth Movers Vs. Commissioner of Income Tax*** *wherein it was held that the amounts set apart by an assessee to meet its liability on account of leave encashment of employees is not a contingent liability*

b. ***Rotork Controls India P. Ltd. Vs. Commissioner of Income Tax, 2009*** *wherein the Supreme Court in the context of an assessee making provision for estimated expenditure towards warranty observed that provision is a liability which can be measured only by using substantial degree of estimation. Such provision is recognized when an assessee had a present obligation as a result of past events, and it is possible that any outflow of resources will be required to settle the obligation and further a reliable estimate can be made of the amount of obligation*

3. Challenges arising on application

Field Level Challenges

1. Audited financials

- Rule 11U of the ITA states that for the purpose of valuation under rule 11UA, the balance sheet used for the FMV computation should be audited. However, in real life, a valuer can come across situations where the financials are still not audited.

- **Possible view:** Valuer should seek audited financials from the management of the company and if the management of the company is not able to provide then seek explanation and take a management representation that they do not expect any material change in the value of assets and liabilities between the provisional financials and the audited financials which would be available at a future date

Field Level Challenges

2. Investment in foreign subsidiaries

- The Rule states that "fair market value of shares or securities as determined according to this rule" shall be considered. Hence, for any investment in subsidiaries, the value of such investments will be computed by doing the same FMV exercise under the Rule by using the balance sheet of the subsidiary. However, how should the valuation of such shares be done if such investment is in a foreign subsidiary?

- **Possible view:** Since such subsidiaries are governed by the jurisdiction of the laws of the land where such subsidiary is incorporated, hence the India tax law and stamp duty law may not be applicable to them and accordingly, one option could be to take the net asset value of such investments as fair value and provide the explanation in the report and reason for such assumption.

Field Level Challenges

3. Valuation date

Rule 11U of the IT Act mandates that, for valuation under rule 11UA, the asset transfer date should be the valuation date. Yet, practical challenges arise when the balance sheet is unavailable on the asset transfer date.

Possible view: Recognizing the rapid value shifts in startup scenarios during successful fund raises, CBDT may have considered the impracticality of aligning with the transaction date's balance sheet requirement. A viable alternative could involve valuing assets as of the latest available balance sheet, with the valuer attesting that no material changes occurred in asset and liability values between the balance sheet and valuation dates.

4. Other Challenges

Other Challenges

1. Share application money pending allotment

The Rule specifies that negative reserves and surplus, excluding those allocated for depreciation, should not be considered as liabilities. In the context of Ind AS, share application money pending allotment, categorized under "other equity," may need adjustment for compliance with this Rule.

Treatment of the same as Liability since it is payable in case allotment is not done

Other Challenges

2. Differential Voting Rights in equity shares

Shares with differential voting rights (DVRs) simply mean that a company has issued more than one class of stocks with different voting rights. A question arises whether the value assigned at equity level reflects the FMV of the share with differential voting rights.

DVRs provide an ability to influence or control the enterprise in a manner that is disproportionate to the percentage holdings.

Other Challenges

3. Treasury shares/ ESOP reserves

Treasury shares/ ESOP reserves Companies which have treasury shares or ESOP reserves, what should be the treatment?

ESOP reserves are the funds earmarked for the employees and thus, while determining the value under the Rule, it can be adjusted as a liability of the enterprise.

Other Challenges

4. What shall be the treatment of Jewelry/ art/ immovable property in case the same is held as stock in trade? As per Rule, these amounts have to be valued at a specific method prescribed by Rule 11UA/ 11UAE.

As per the rule, there is no mention of whether the asset is held as stock in trade or not. Hence, it can be revalued as prescribed in rule after deducting the same from Total assets

Other Challenges

5. Practical Challenge is faced by professionals for valuation of unquoted equity shares since it is not feasible to get balance sheet of all the group companies in case of multi layered corporates

Other Challenges

6. Rule 11UA applies to unquoted shares of a company. However, a technical query is about whether the similar provisions apply for valuing share in a partnership firm or LLP?

Other Challenges

7. **"Expenses disallowed due to non-payment u/s. 43B"**

Issue - Where the expenses are disallowed u/s. 43B on account of failure to pay the liabilities within the due date (including failure to make MSME payments within the prescribed time limit provided under the MSME law, the same being disallowed u/s. 43B) in the subsequent period, such expense is allowed upon payment of the said liabilities. In such a case, how does the amount of disallowed expense which will be allowed in the future upon satisfaction of prescribed conditions, affect the valuation under Income tax?

Judicial Case Laws

Case Laws on Methods of valuation – Part 1

i. Where a method has been prescribed by the legislature, that method alone shall be followed for computation of the fair market value. The legislature in its wisdom has also given a formula for the computation of the fair market value which cannot be ignored by the authorities below. The tax officer has to compute the fair market value following the prescribed method and he cannot adopt the market value as fair market value. - **Medplus Health Services (P.) Ltd. v. ITO [2016] 68 taxmann.com 29/158 ITD 105 (Hyd. - Trib.)**

ii. The assessee has all the right to choose a method i.e. NAV Method (Book Value) or DCF Method which, cannot be changed by the tax officer. The method adopted for valuation should be based on relevant materials and if based on relevant material even the Court will not interfere with such a finding of fact. - **Duncans Industries Ltd. v. State of U.P [CA No. 5929 of 1997] (SC)**

iii. The tax officer is undoubtedly entitled to scrutinise the valuation report. The Tax Officer has not only a right but he is also duty-bound to examine the valuation report evaluate it and record his findings on the same. Such finding should be based on relevant material and the rational view taken judiciously. - **Microfirm Capital (P.) Ltd. v. DCIT [2018] 89 taxmann.com 23 / 168 ITD 301 (Kolkata - Trib.)**

Case Laws on Methods of valuation – Part 2

iv. The Tax officer may determine a fresh valuation either by himself or by calling for a final determination from an independent valuer to confront the petitioner. However, the basis has to be the same method and it is not open to him to change the method of valuation which has been opted for by the Assessee and to modify the figures as per his whims and fancies. - **Vodafone M-Pesa Ltd. v. Pr. CIT [2018] 92 taxmann.com 73 (Bombay)**

v. DCF method is a recognized method where future projections of various factors by applying hindsight view and it cannot be matched with actual performance. Valuation under DCF is not an exact science and can never be done with arithmetic precision, hence the valuation by a Valuer has to be accepted unless specific discrepancy in the figures and factors taken are found. - **India Today Online Pvt. Ltd. ITO, ITA Nos. 6453 & 6454/Del/2018, (Delhi ITAT) AY 2013-14 & 2014-15 Date of pronouncement of 15/03/2019**

vi. In any case, the tax officer cannot ask the assessee to prepare the valuation report based on actuals which are not contemplated in Rule 11UA(2)(b). - **Rameshwaram Strong Glass (P.) Ltd. v. ITO [2018] 96 taxmann.com 542/172 ITD 571 (Jaipur - Trib.)**

Case laws on “Whether Assessing Officer can change method of valuation from DCF method to Net Asset method?” – Part 1

Cases in favour of Assessee:

i. Where assessee-company had allotted equity shares at a premium and valued same on basis of DCF method supported with valuation report prepared by Chartered Accountant, since method adopted by assessee was in accordance with rules contained in Explanation (a)(i) to section 56(2)(viib), Commissioner (Appeals) had rightly deleted addition made by Assessing Officer under section 56(2)(viib) - **[2023] 155 taxmann.com 338 (Delhi - Trib.)**

ii. Where assessee raised funds by issuing shares at premium, since assessee got its share valued from a prescribed expert as per rule 11UA(2)(b) of IT Rules and arrived value of each share at certain sum calculating same as per Discount Cash Flow Method, said valuation done by assessee as per prescribed method could not be rejected. - **[2023] 152 taxmann.com 532 (Delhi - Trib.)**

iii. As per section 56(2)(viib) read with rule IIUA, assessee has an option to do determine valuation of shares either on DCF Method or NAV method and once assessee has exercised an option, Assessing Officer is bound to follow same - **[2023] 155 taxmann.com 578 (Delhi - Trib.)**

Case laws on "Whether Assessing Officer can change method of valuation from DCF method to Net Asset method?" – Part 2

Cases in favour of Assessee:

iv. Where AO rejected DCF method of valuation adopted by assessee to determine value of shares issued by it on premium and determined value of shares on basis of Net Asset Value (NAV) method, since AO had adopted different method to determine value of shares without scrutinizing valuation report furnished by assessee under DCF method, impugned order was to be set aside and matter was to be remanded. - **[2021] 125 taxmann.com 73 (Bangalore - Trib.)**

v. Where Assessing Officer rejected DCF method used by assessee for valuation of shares issued on premium for reason of inconsistency in projected and actual financials and adopted NAV method instead, since assessee had justified premium charged on issuance of shares and, further, there was a minor difference in projected and actual financials, impugned rejection of DCF method adopted by assessee was unjustified. – **[2022] 145 taxmann.com 356 (Chennai - Trib.)**

vi. Where revenue was unable to point out any mistake in manner of application of valuation methodology followed by Chartered Accountant of assessee in terms of Explanation (a)(ii) to section 56(2)(viib), Assessing Officer could not have rejected this valuation methodology and changed it to Explanation (a)(i) to section 56(2)(viib) - **[2022] 142 taxmann.com 297 (Mumbai - Trib.)**

Case laws on “Whether Assessing Officer can change method of valuation from DCF method to Net Asset method?” – Part 3

Cases against Assessee:

i. Where assessee allotted shares to a company and fair market value of shares was done by a Merchant banker only on basis of Direct Cash Flow (DCF) method, only depending on data supplied by assessee and no evidence was produced for verifying correctness of data supplied by assessee, Assessing Officer was justified in rejecting DCF method and adopting Net Asset Value method – [2018] 94 taxmann.com 112 (Delhi - Trib.)

ii. Where assessee allotted shares to a company on premium and fair market value of shares was done by Chartered Accountant on basis of Direct Cash Flow (DCF) method only depending on information about future projections provided by management of assessee, since assessee could not conclusively establish that such projection/estimation done by its management was on a scientific basis, Assessing Officer was justified in rejecting valuation done by Chartered Accountant - [2019] 102 taxmann.com 59 (Bangalore - Trib.)

Miscellaneous

Definitions of few important Terms

Meaning of the term 'Balance sheet' - For the purposes of determination of such FMV, the valuation rules (Rule 11U and Rule 11UA of the Income Tax Rules 1962 (IT Rules)) define the term 'balance sheet' as - the balance sheet of the company as drawn up on the valuation date (i.e., on the date of issue of shares) which has been audited by the auditor of the company appointed under the Companies Act, and if no balance sheet is drawn up on the valuation date, then the balance sheet drawn up as on a date immediately preceding the valuation date which has been approved and adopted in the annual general meeting of the company. *Electra Paper and Board Pvt Ltd v. ITO [ITA NO.222/Chd./2021*]`

A registered valuer is a professional registered with the Institute of Valuers and authorized to carry out valuations of property and assets as per the guidelines set by the government. The qualifications for registration as valuers of different classes of asset are specified in sub-rules (2) to (11) of section 8A(1) of the Income Tax Act.

The Income-tax Rule 11U provides that the **valuation date** is the date on which property or consideration as the case may be is received by the taxpayer. However, Income-tax Appellant Tribunal has held that in case of [Cimex Land and Housing Pvt. Ltd v ITO LD/67/128 (Delhi ITAT) ICAI Journal April 19 pg 1465 AY 2015-16, Order dated 25/02/2019] issues of shares under section 56(2)(viib) share allotment date is relevant and not the date of receipt of share application money. Pricing of share needs to be justified when shares are issued.

For the purpose of the valuation option has been provided for the balance sheet. It can be the drawn up as on a date immediately preceding the valuation date which has been approved and adopted in the annual general meeting of the shareholders of the company, if there is no audited balance sheet as on the date of issue of shares.

Thanks!

Any questions?

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