

Issues in Valuation and S.56

-Dr. Anup P. Shah

19th February 2022

TAXCON 2022

Scope

▶ Income from Other Sources – S.56(2)

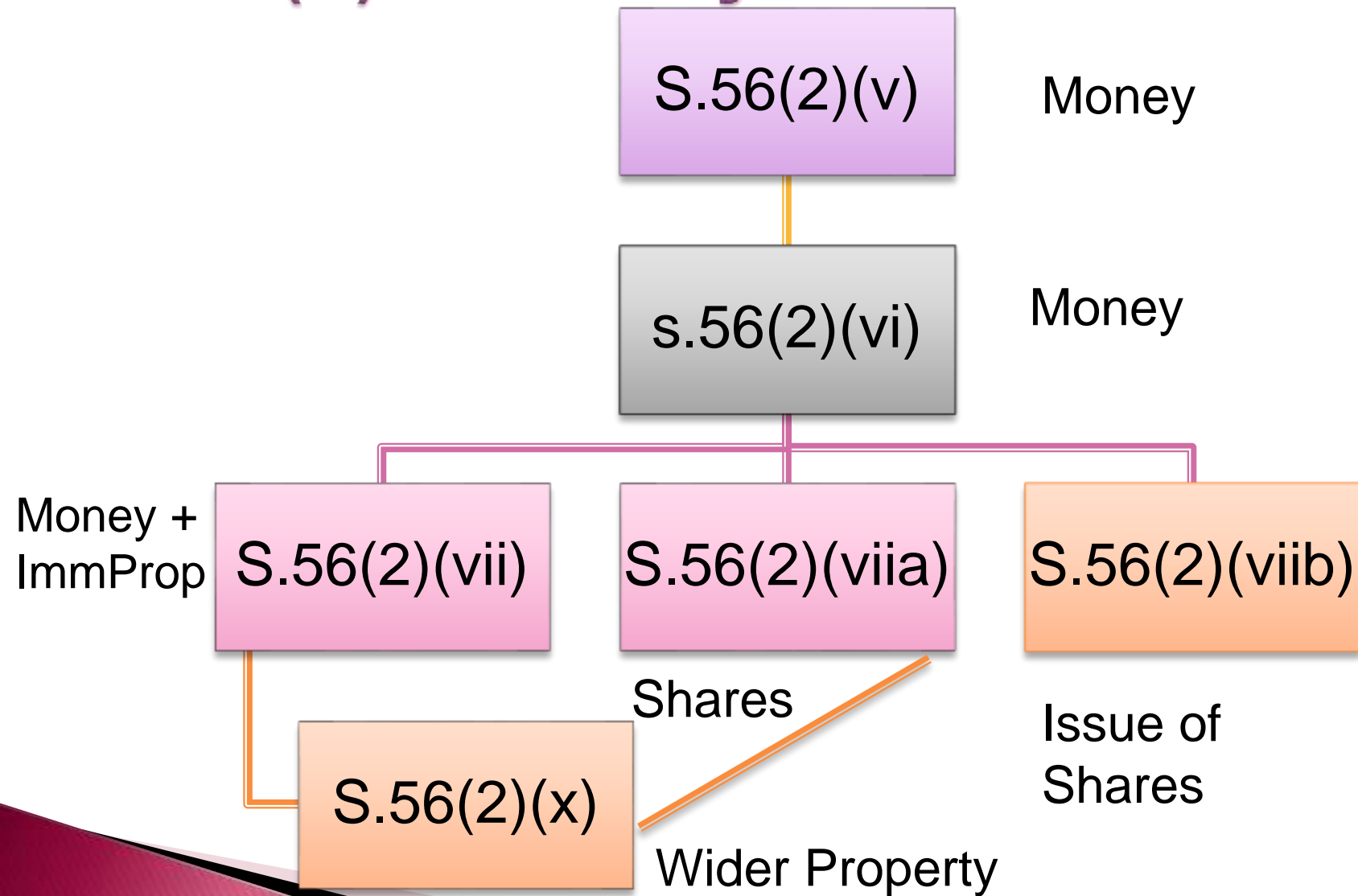
- S.56(2)(x) Receipts for No / Inadequate Consideration
- S.56(2)(viib) – Issue of Shares @ Premium

▶ Valuation

- u/s. 56(2)(x)
- u/s. 56(2)(viib)

Income from Other Sources- S.56(2)(x)

S.56(2) - History



Section 56(2)(x)

“56(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head “Income from other sources”, namely :—

.....

(x) where any person receives, in any previous year, from any person or persons on or after the 1st day of April, 2017,—

(a) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum;

(b) any immovable property, -

.....

(c) any property, other than immovable property,—

(A) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;

(B) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration :

Coverage

- S.56(2)(x) - From AY 2017-18 / PY 2016-17
 - Applies to receipt by any person – Res / NR / RNOR
 - Definition u/s. 2(31) – earlier sections did not expressly apply to AOP / BOI / Listed Company – Now no distinction in applicability
 - Applies to receipt from any person – except certain Exemptions
 - Applies @ stage of receipt of property – on or after 1-4-2017
 - Receipts prior to 1-4-2017 covered by earlier s.56(2)(vii)/(viiia)
 - Property expressly defined in Explanation (d) - **Exhaustively**
 - Proviso to s.56(2)(x) provides for certain Exemptions
 - Explanation (e) defines Relative – one of the specified Exemptions
 - Rule 11U /UA lays down Method of determining FMV

Coverage

- S.2(24)(xviiia) – Definition of Income amended to include s.56(2)(x) receipts
- S.49(4)(x) – COA of Property= FMV adopted u/s. 56(2)(x) → Cost Step up
- **Reasons – Memorandum explaining the FB 2010 / 2017**

*“... introduced as a counter evasion mechanism to **prevent laundering of unaccounted income** under the garb of gifts intended to extend the tax net to such transactions in kind. The intent is **not to tax the transactions entered into in the normal course of business or trade**, the profits of which are taxable under specific head of income*

*“ The existing definition of property for the purpose of this section includes immovable property, jewellery, shares, paintings, etc. **These anti-abuse provisions** are currently applicable*”

Coverage

- If receipt by Minor for inadequate consideration – who would be taxed u/s.56(2)(x)?
 - Person could be any Individual - minor or major
 - Income of Minor u/s. 56(2)(x) if any to be clubbed with his father / mother u/s. 64
 - If minor has received then exemptions to be considered qua him and Not qua his parent **(Mum ITAT)**

Consideration

- Property must be received without Consideration
- Q. What is Consideration – not defined ∴ reference to Indian Contract Act – **(Mum ITAT)**
 - Definition u/s.2(d) of Indian Contract Act, 1872
 - Any Act or Abstinence on the part of one party at the desire of the other – can be past / present / future
 - Can flow from 3rd Party / Stranger even if no privity to Contract – **Chinnaya v Ramayya (Mad)**
 - Can flow to 3rd Party and would yet be a valid consideration – **Keshub Mahindra v CGT (Bom)**
 - Q. Would these 2 Principles be valid for s.56?

Consideration

- Alimony Receipt?
 - Received in lieu of maintenance obligations, hence, exempt
 - **(Del ITAT) / (Mum ITAT)**
- Motor Accident Compensation?
 - Is not physical / mental agony suffered consideration enough?
 - Interest on Compensation not taxable – **(Ahd ITAT)**
- Loan which is to be repaid is not a receipt of sum of money
 - 0% Interest Loan is normal in business – many factors
 - **Chandrakant Shah (Bom) / Saranpal Singh (P&H) / Paramveer Sancheti (Nag)**

Consideration

- Compensation for agreeing not to contest a Will
 - Consideration has to be understood as per Contract Act, 1872
 - Agreeing not to contest will is sufficient consideration **(Mum)**
 - Harassment compensation
 - Is it not a capital receipt - mental anguish a consideration?
 - Not taxable u/s. 28 in case of **(Mum ITAT)** but s.56 not examined!
 - PMS Funds for making MF investment
 - Were returnable to Owner – not the UBO of Funds **(Mum ITAT)**

Consideration

- Advance received towards land sale
 - Land not yet transferred
 - Agr. for Land Purchase executed – Advance not taxable even if no efforts made for recovery for 3 years since no evidence by AO to show that Advance was a Gift **(Mum ITAT)**
- Compensation on Cancellation of Contract
 - Termination of contract is valid act - Not taxable **(Bang ITAT)**

Consideration

- Award recd by Amateur Sportsman
 - If Professional Sportsmen – awards are taxable u/s. 28
 - However, for Amateurs these are Capital Receipts
 - S.10(17A) + Circ.447 exempts such Awards
 - S.56(2)(x) also not applicable in such cases
 - (Del ITAT)

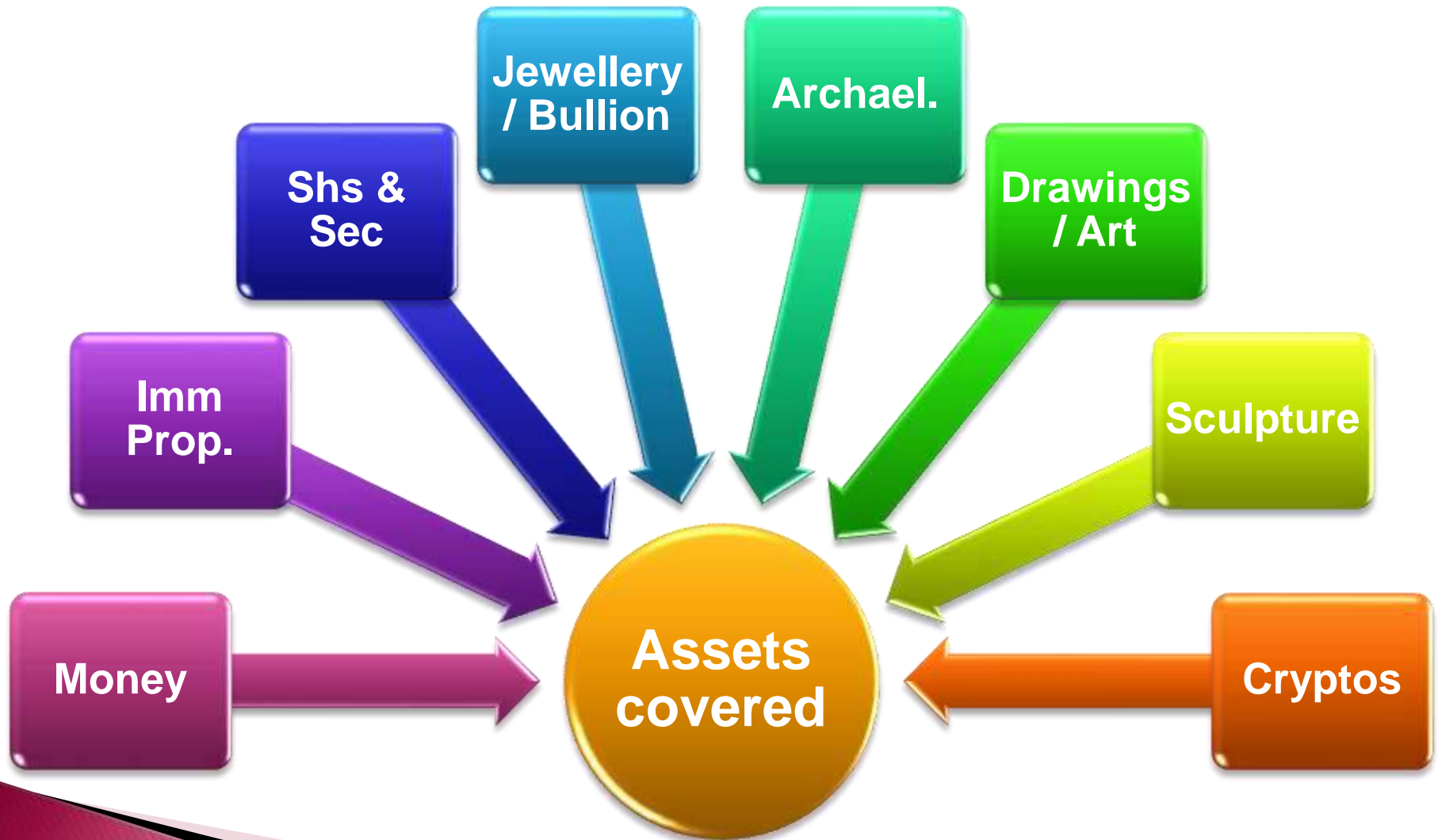
Nature of Property

- Property received must be **Capital Asset** for Recipient
 - Character in hands of Transferor / Donor immaterial
- Definition of term Capital Asset used in s.56. - S.2(14) definition applies for entire ITA including for s.56
 - Very wide but for s.56 only certain Properties from these
 - What is not CA u/s. 2(14) would be excluded for s.56 + specific exceptions u/s. 56(2)(x) would also be Excluded.
 - Rural Agr Land not CA – Not covered u/s. 56 **(Jpr) / (Pune)**

Nature of Property

- S.56(2)(x) NA if Property is SIT for recipient (**Jpr**)
 - Jewellery / Bullion for Jeweller / Gold Trader
 - Shares for Stock Broker / Trader / Jobber
 - Art / Paintings for Art House
- What if treated as SIT on Receipt & thereafter converted to Capital Asset?
 - S. 28(via) – FMV u/R. 11UB taxed as Business Income

S.56(2)(x) Scope of Property



Imm. Property

- Imm. Prop means **Land & Building**
 - Memo Expln to FB 2009 / CBDT Cir 2010
- U/s. 50C various decisions have held
 - Leasehold Rights are not Imm. Property
 - Defn. of Imm. Prop u/s. 269UA (37-l) very wide and all encompassing. Not so u/s. 56
- TDR is interest in land but not Imm. Property u/s. 56 – only L&B covered – **(Bang)**
- Letter of Flat Booking issued by Builder at stage of booking + Part consideration paid constitutes Agr. between Builder and Purchaser – This fact is repeated in regd MOFA Agr. - SD Value as on that date to be compared with Actual Price – **(Jpr) Fact Specific View**

Nature of Property

- Q. Imm. Property must be Capital Asset or can be SIT?
 - Property Defn. = Imm. Prop. Being L&B but s.56(2)(x)(b) refers only to receipt of Imm. Prop. and not Property
 - Imm. Prop. Not restricted to L&B – **Trilok Chand Sain (Jpr)**
 - **Does not appear to be correct view –**
 - CBDT Cir 1/2011- Bus. Assets excluded from purview of Property
 - **Imm. Prop. Should be restricted to definition of Property ~ must be L&B which is a CA for recipient**
 - **Else definition of Imm. Prop. In Property becomes redundant**

Shares & Securities

- ▶ No Definition of Shares / Securities
 - Meaning under Companies Act, 2013 / SCRA 1957
 - Share = Equity / Preference / Non-Voting Right / Differential Voting Right Shares and Listed / Unlisted
 - Securities = S.2(h) of Securities Contract Regulation Act
 - (i) *Shares, bonds, debentures, or other marketable securities of a like nature in or of any incorporated Company;*
 - (ii) *Derivatives ;*
 - (iii) *Units of Mutual Fund / CIS*
 - (iv) *Security Receipts*
 - (v) *Rights in Securities – Warrants*
 - (vi) *Stock Options*

Shares - Allotment

- ▶ Is Allotment of Shares covered?
 - Section applies when there is a receipt of shares
 - Is an Allotment of Shares a Receipt?
 - Allotment is a creation of shares different from secondary purchase which is a transfer / receipt – **Khoday Distilleries (SC)**
 - However, in **Sudhir Menon HUF (Mum)**
 - Receipt of shares is after allotment when shares are in existence
 - If disproportionate allotment – some shareholders subscribing and others not – gains to some at cost of others ∴ S.56 gets triggered
 - If Pro-rata Allotment – No Tax
 - A & NZ HC in **Robertson's case** – issue @ lower than FMV to some Shareholders results in lowering value of other SHs. ∴ Deemed Gift under Australian / New Zealand Gift Tax Acts
 - Appeal against Mum ITAT admitted by Bom HC in Sept 2018

Shares – Allotment by Fly. Co

- Is Allotment of Shares covered if issue made by a Co where all SHs are Relatives?
 - Rights issue made by such a Co
 - Subscribed to by 1 of 7 SHs – all 7 were relatives u/s. 56
 - BV of Shs were Rs. 416 but Issue @ Rs. 100
 - Entire Issue subscribed by 1 as other 7 did not exercise their rights
 - **Held, transactions between close relatives were exempt**
 - Though allotment only to 1 SH – entire Shareholding within Family
 - Renouncement was from close relatives / assessee could transfer to close relatives without attracting tax
 - Surrender of rights in favour of relative was exempt
 - Trf of Shs under FS did not attract CGT also
 - Not a case of Black Money / Tax evasion
 - Thus, no tax u/s. 56(2)
- **(Vishak.)**

Shares – Twist in the Tale

- Pro-rata Issue of shares by Pvt Co to promoters – **Less than offer subscribed** by one Shareholder
- Shs issued pursuant to Lenders' covenant to increase Co's Net Worth
- Held, **Lower than Proportionate Allotment does not attract rigours**
 - **Disproportionate means Higher** than Others
 - SH became poorer in value as his % reduced
 - S.56 NA to bona fide business transaction?
 - **CBDT Cir 1/2011: Sec is anti-money laundering measure** not for taxing genuine transactions carried out in normal business
 - Consideration through bank = no hint of money laundering by AO
 - Where is the benefit being received by the Shareholder

Shares – Bonus Issue

- No unjust enrichment in case of Bonus Allotment – pro-rata bonus issue to all SHs
 - Never without consideration – Fall in intrinsic value of original shares is consideration. Money remains with Co. SHs get nothing extra – **Dr Rajan Pai (Kar)**
- Q. What if Promoters forgo Bonus entitlement?
 - E.g., Reliance Power Ltd
 - Enrichment of those who are allotted Bonus at cost of Promoters?
- Bonus Issue Not a distribution of profits
 - What if Bonus NCDs / Bonus Preference Shares issued?
 - Specific provision u/s. 2(22)(a) – Specific Overrides General

Shares - Conversion

- Equity Shares issued on conversion of CCPS / CCDs
 - Can s.56(2) get triggered on conversion?
 - Conversion of CCD / CCPS is an exempted Transfer u/s. 47 but not exempted u/s. 56(2)
 - Compare FMV on which date – conversion or issue of hybrids?
 - FDI Policy: Conversion Price \geq FMV on Date of issue of Hybrids
 - Cos Act – Price of Eq Shs can be determined upfront or on conversion
 - As long as Issue Price of Hybrid \geq FMV u/s. 56 on issue date, there cannot be a 2nd examination on Date of issue of Equity Shares

Shares - Conversion

- Equity Shares issued on conversion of CCPS / CCDs
- If applicable – problems for Private Equity / Venture Funding
 - Earn-out based conversion: Perform as Projected – lesser shares issued to Investor but if Performance lower than Projected then More Shares issued to Investor.
 - Q. What if conversion of a loss-making company takes place at below then prevailing FMV e.g., in Start-ups / E-commerce Cos?
 - Would PE / Angel Investor end up paying tax u/s. 56(2)(x)?

Shares- Buyback / Reduction

- Can Buyback / Reduction of Shares by a Company @ lower than FMV be treated as Income of the Co?
 - Co. must extinguish & physically destroy bought back shares within 7 days of receipt
 - Shares cease to exist altogether after cancellation
 - Paid-up capital of Company cancelled to that extent
 - Can Co. be said to have received property which is cancelled
 - Specific provisions for taxation
 - Buyback – BBT for Unlisted Cos + s.46A for Listed Cos
 - Reduction – S.2(22)(d)
 - **Vora Financial Services (Mum) – Appeal admitted by HC**

Jewellery / Bullion

- Jewellery ~ Inclusive definition u/s. 2(14) Capital Assets:
 - Ornaments of gold, silver, precious metals, precious stones, whether or not sewn into any apparel
 - Precious / semi-precious stones whether or not set in furniture / utensils / articles / apparels
 - Q. Would the above definition hold good for s.56?
- Bullion – Gold / Silver reckoned by mass / weight
 - Raw Gold in form of Ingots / Bars. Q. What about Gold Coins?
 - Q. What if any other metal is reckoned by mass, e.g., Platinum?
- What about personal effects such as silver utensils ?

Archaeological / Drawings

- Archaeological / Drawings / Paintings / Sculptures / Work of Art:
 - Archaeology – Study of Antiquities / Human History / relics
 - Drawings / Paintings / Sculptures – general definition
 - Work of Art – Cambridge English Dictionary: Object made by an artist of great skill, especially a painting, drawing, or statue
 - Painting, sculpture, poem, piece of music, or other product of the creative arts
- Q. Whether following covered?
 - Collection of Stamps / Antiques which are not covered above
 - Ancient Books – Not a Drawing / Art / Painting?

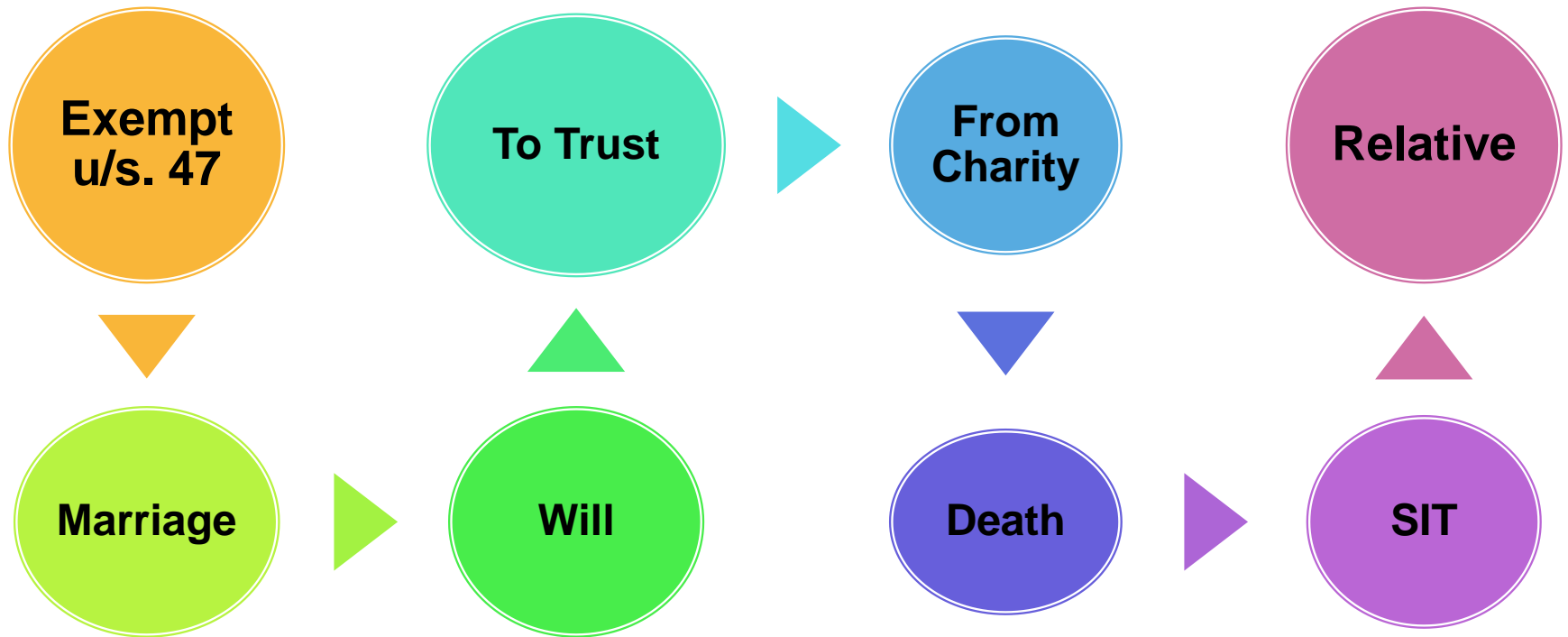
VDAs added from 2022-23

- VDAs added in definition of property from 1st April 2022
 - Even covers loyalty points / reward points / In-app rewards
 - But is a Receipt of the same without consideration? What if granted on special occasions like birthdays? Even then given to loyal customers – is that not a consideration?
- Gift of VDAs which is not exempt would trigger s.56(2)(x)
 - Currently several gifts being given in form of crypto transfers
- Valuation of VDAs would be required u/R11UA
 - FMV of listed crypto assets would be easy
 - What if not listed / quotes not easily available?
- VDAs received by Miners also covered?

Items which can yet be Gifted

- Exhaustive Definition – if not covered then not property
 - Precious Watches not made of Gold / Silver / Diamonds – not Jewellery not Bullion
 - Expensive Pens
 - Cars / Yachts / Airplanes / Bikes / Helicopters
 - Expensive Food & Wine
 - Clothing / Bags
 - Luxury Vacations / Travel
 - Furniture / Electronics / Laptops / Mobiles
 - Business Undertaking / IPRs
 - Crypto currency – **ONLY till 31st March 2022!**

Exemptions



Exempt u/s. 47

Exempt u/s.47 – Not treated as Trf	Exempt u/s.47 – Not treated as Trf
Receipt on Total / Partial Partition of HUF	Receipt of CA by successor Co-operative Bank in reorganisation
Receipt by Indian WOS from Holdco	Issue of Shares by Successor Co-operative Bank in reorganisation
Receipt by Indian Holdco from WOS	Receipt of CA by Bank on merger with a Bank
Receipt of CA by Amalgamated Indian Co	Receipt of CA being shs in ICo by FCo on merger with another Fco
Receipt of shares from Amalgamated Indian Co	Receipt of CA being shs in ICo by FCo on Demerger with another Fco
Receipt of CA by Resulting Co under a Scheme of Demerger	
Receipt of shares from Resulting Indian Co under Scheme of Demerger	

Exempt u/s. 47- Issues

- Trf between Holdco & WOS - If relationship not maintained for 8 yrs – would tax u/s56 also be attracted?
- Issue of shs under Merger / Demerger
 - Exemption qua Eq / Pref both
 - Not if Bonds / Debentures issued
 - What if money issued for fractional shares?
 - Available even for merger of Fco into ICo
 - If what is demerged is held not to constitute an undertaking u/s. 2(19AA) – e.g., Land in **Uma Enterprises (Raj)** then no exemption u/s. 47 & ∴ no exemption u/s. 56(2)?
 - **Can issue of shares under Merger / Demerger be taxed at all even if No Exemption?**
 - Is it a case of abuse of provisions?

On Occasion of Marriage

- Must be received personally by Individual getting married
 - Brides and Grooms both covered
 - Not by her father / mother – **Rajinder Mohan (P&H)**
 - Receipt on occasion of marriage – hence, can be received prior to or post marriage but within reasonable proximity
 - Can be received from any one – even a stranger
 - Any amount of gifts received on marriage – no limits
 - **Covers 2nd / 3rd marriages also – no limits**
 - Does not exempt Engagement or similar Functions

Under Will / Inheritance

- Can be received from anyone –even a Stranger/ Client
 - Receipt under Will is Testamentary Succession
 - Inheritance – Transmission by descent /succession
- Testamentary or Intestate Succession (Hindu Succession Act / Indian Succession Act) both covered
- Not necessary that **Probate / Succession Certificate** or **Letter of Administration** obtained for Exemption
 - Those are Legal Formalities with which ITA has no concern
 - But for demonstrating to AO – Will / Succession Certificate / Legal heir Certificate would be helpful

Under Will / Inheritance

- Q What if Asset received as a Nominee?
 - Not a case of Will / Inheritance
 - But Nominee does not receive at all – he is only a stop gap arrangement
 - SC in numerous cases upheld the superiority of Will / Succession
 - **Sarbati Devi** –Life Insurance Policy Nominee
 - **Vishin Khanchandani** – Nominee of NSC
 - **Indrani Wahi** – Nominee of Flat
 - **Ramesh Chand Talwar** – Bank Account
 - **Shipra Sengupta** – PPF Account Nominee
 - Hence, no receipt of property – no tax u/s. 56(2)

Contemplation of Death

- ***Donatio mortis causa***

- Gifts made by someone who expects to die in near future
- S.191 of Indian Succession Act, 1925 applies to movable gifts given to be kept if donor dies from expected illness but which would be resumed if he survives
 - Gift Tax Act had similar conditions – **Abdul Karim Mohd (SC)**
 - No such conditions u/s. 56 – need not be resumed by Donor
 - But **F. Susai Raju (Chenn)** relied on s.191 of ISA to interpret term. Is this correct?
- Not necessary that Donor is a relative

Contemplation of Death

- ***Gift pursuant to become Sadhvi / Saint***
 - Gift deed pursuant to taking up Sanyas / becoming Jain Sadhvi
 - Contended that amounted to Civil Death hence gift was exempt as under a Will / contemplation of Death
 - Held, while Hindu Law treats it as a Civil Death, ITA requires physical death
 - Hence, treated as a Gift by her
 - **(Mum)**

From / by Charitable Trust

- From any Charity / Trust / Institution / University / Education Institution / Hospital / Medical
- From / By any Trust registered u/s. 12/12AA
- Q. Whether Issue of shares by such a Trust (s.25 Co) at lower than FMV can be held to be exempt?

From any Relative

- Gift received from defined relatives only is exempted
 - No occasion to be proved – **P Chandrasekhar (AP &T)**
- Uncle / aunt relatives of nephew/niece but converse not so?
 - *U is a relative of N but N is not a relative of U??*
 - Gift from Brother but made from Bank A/c of nephew – **Gulam Farooq Ansari (Raj)** – taxable but c/f **Ramesh Garg(Chd)**
 - Can nephew gift to his father and father again to his brother?
 - **GAAR applicability?**
- Mother's sister's son / cousin not a relative – **(Chen ITAT)**

From any Relative

- Lineal Ascendant / Descendant : Not defined
 - Relatives in a straight line - Grandfather, Father, Son ↑ OR ↓
 - Q. Grandmother, Mother & Daughter / Grandmother, Mother & Son?
Yes. **Dhanilal Devilal (Raj)**
- What about **Adopted Children / Step Children**?
 - No express provision - Defn. of child u/s 2 – Inc'd **Adopted / Step-child**
 - Adopted Yes in case of Estate Duty – **Nulli Laxminarayan (AP)**
 - Adopted child is child of adoptive parents – **Chandan Bilasani (SC)**
 - Step child Not a Legal Heir under HSA – **Lachman Singh (SC) / Dudhnath Kallu Yadav (Bom)**

Gift from Relatives & S.68

- If any gift received from Relative would s.68 yet have to be satisfied?
 - S.68 requires 3 conditions to be met for a gift not to be taxable – ICG – Identity / Creditworthiness / Genuineness
 - Gift received from relative (say brother) exempt u/s. 56. Does that ipso facto make it exempt u/s. 68?
 - No. S.68 and s.56 operate in different spheres.
 - Gift from relative where capacity of donor not proved would lead to taxation u/s. 68
- **Sunil Thomas (Ker)**
- **Converse is also true**
 - Gift received by uncle from nephew where ICG Proved by Donee. No tax u/s. 68 in uncle's hands but s.56(2)(x) applies since Nephew is not an exempt relative

From any Relative – HUF Conundrum

- Gift received by member of HUF from HUF – taxable?
 - HUF is a Group of Relatives of Donee
 - Relative can be in plural also
 - ✓ If all members of HUF are relatives of Donee – no tax - (*Rajkot / Mum/ Hyd/ Chd ITATs*)
 - ✗ Gift recd by HUF from Karta's mother held Not exempt even though collectively all members were relatives of Donor – (*Del ITAT*)
 - ✗ Even if all members relatives – HUF not a relative – gift not exempt – *Gyandchand M Bardia (Ahd)*
 - Q. What if HUF comprises of members who are non-relatives, e.g., Cousins (father's brother's son)?
 - ***Still be exempt?***

From any Relative

- **Family Settlement**

- What if property recd from non-relative on account of FS – say from cousin or by uncle from nephew?

- ***Is it a receipt without consideration?***

- Giving up of acrimony / disputes; getting mental peace and preserving family honour – is it not adequate consideration?
- FS not a transfer under General Law nor under ITA
 - **Kale (SC) / Tek Bahadur (SC) / Ram Charan Das (SC) / CA Natarajan (Mad) / Ziauddin Ahmed (Gau)**
- Property received on account of FS not taxable u/s. 56 – **(Mum)**
- Genuineness of FS a must - Else GAAR can be invoked!
- Amt on Partition of HUF – exempt – **(Mum/ ChD)**

To any Trust

- Settling any amount on a Private Trust
 - Exemption in hands of Trust only if it is created by an Individual solely for the benefit of his Relative/s
 - Must be a Private Trust – not Charitable
 - Discretionary or Specific
 - Settlor must be Individual – gift from corporates not exempt
 - Exemption only to Settlor or also to other Donors if Trust created for benefit of relatives of Donor?
 - No condition that settlement must be by Donor himself!
 - Trustees could be Individual or Corporate – not material
 - Bs must always be Indv – only then they would be relatives
 - Can a Trust comprising of relatives be a B of another Trust – Master-Sub-Trust concept?
 - Would such a Trust be a relative of the Donor?

To any Trust

- General Exemption u/s. 56 – Donor must be Relative of Recipient - check from Donee's angle
- However, for Trust exemption – Beneficiaries of Trust must be Relatives of Donor
 - Hence, instead of checking relationship from Donee's perspective now need to check relationship from Donor's angle !
- **Examples**
 - 1) **Gift by Uncle to Nephew** – Exempt since Uncle is Relative of Donees
 - 2) **Gift by uncle to Trust set up for benefit of Nephew** – **No** Exemption to Trust since Nephew is not a Relative of Donor
 - 3) **Gift by Nephew to Uncle** – **Not** Exempt since Nephew is not relative of Donee
 - 4) **Gift by Nephew to Trust set up for benefit of Uncle** – Exemption to Trust since Uncle is a Relative of Donor

S.56 & NR

- Share sale of Fco by one NR to another NR. Fco derives substantial value from Indian Co.
- Indirect Transfer of Fco gives rise to CGT in India u/s. 9
- Q. What if Buyer buys @ below FMV? Can s.56 apply?
 - Excess of FMV over Consideration = IOS
 - S.5 Total Income of NR includes Income accrued in India
 - Thus. IOS u/S.56(2)(x) can be taxed in India in hands of buyer
 - Also check taxability of IOS under DTAA
 - DTAA of India-UAE
 - Specific IOS Clause. Is taxable only in UAE and not in India
 - DTAA of India-Singapore
 - No IOS Clause. Residual Income may be taxed in India

Valuation u/R11UA -ImmProp

- If SDRRV exceeds 10% of Consideration + Rs. 50,000 then section attracted in case of Inadequate Consd.
 - SDRRV is Rs. 5cr. Agr Value is Rs. 4.5 cr. Excess of Rs. 50 lakhs is greater than Rs. 45 lakhs (10% of Agr Value).
∴ Amt taxable is entire excess of Rs. 50 Lakhs
- Q. Imm. Property = Land and Bldg only or even Rights in Land / Building.
- How to value Imm Prop situated abroad?
- RR of Mumbai divides Mumbai City into various **Village Nos.** and **Names**
 - Village → **Zones & Sub-Zones**
 - Each Sub-Zone has different **CTS Nos.** for various properties

Valuation u/R11UA -ImmProp

Using RR for a Property – 9 Steps

1. Division / Village No. & Name
 2. Zone & Sub-Zone
 3. CTS No. of Land
 4. Type, e.g., Residential, Office, etc.
 5. Built-up Area / BUA ($\text{BUA} = 1.2 * \text{Carpet Area}$)
Not for Carpet Area or Super Built-up Area
 6. MV Rate for Property ($\text{In Sq. Mtr.} = 10.764 \text{ Sq. Ft.}$)
 7. Special Factors
 8. Prescribed + / - Adjustments to Rate
 9. $\text{MV for SD} = \text{Adj. Rate} * \text{BUA}$
- **Special Factors : Depreciation** as per age of structure
 - Ranging from Nil for 2 year old structure to 70% for 60 years + structure
 - Proof of Age must : OC / BCC, Municipal Assessment, Electric Bill / Telephone Bill

Valuation u/ R 11UA - Shares

- Quoted Shares / Securities
 - Quoted on RSE with regularity from time to time
 - How to determine regularity?
 - Can one adopt Objective Test of Frequently Traded specified under the **SEBI Takeover Code**?
 - **RSE** – Only a Stock Exch. in India can be recognised under SCRA
∴ Foreign St Ex cannot be a RSE
 - Hence, shs of Foreign Listed Cos would never be treated as Quoted Shares and would always have to be valued as per Adjusted Book Value Method u/ R 11UA.
 - **Even sale of Apple / Google / Microsoft – sale of Unquoted Shs?**
 - Highly absurd proposition that the most valuable listed cos in the World are treated as unquoted by the ITA

Valuation u/ R 11UA - Shares

- Unquoted Shares / Securities
 - **Adjusted Book Value Method by CA / MB**
 - (A-L) X Paid-up Value of Equity Shares / Paid-up Equity Cap
 - Require Audited B/S as on the date of acquisition of shs – how possible if mid-year ~ more so, how would a minority SH get it?
 - Can nearest B/s be taken – Yes under Gift Tax Act
 - **Option of B/S of closest Yr possible in (viib) not in (x) – Why?**
 - Section attracted on receipt of shares – B/S of that year. What is receipt in case of transfer of shares?
 - Transfer complete when duly signed blank transfer forms are handed over to transferee – **VR Shelat v PJ Thakur (SC)**

Valuation u/ R 11UA - Shares

- Underlying value of foll. Assets substituted
 - Jewellery / Art ~ Open Market Price by Regd. Valuer
 - Shares / Sec – in manner provided in this Rule
 - Immovable Property – SD RRV
 - What if Co. has JDA / Transferrable Development Rights / Tenancy Rights?
 - Should they be treated as Imm. Prop. No definition in Rule so can on rely on definition under Section?

Valuation u/ R 11UA - Shares

- **Reduce Liabilities**

- BV of Liabilities shown in B/s
- Exclude Provisions made for meeting Unascertained Liabilities
 - Provisions for Ascertained Liabilities to be reduced from Value
 - Ascertained Liability (**AL**) is Opposite of Contingent Liability (**CL**)
 - **Ind AS 37**: AL a Present Obligation vs CL is a Possible Obligation whose existence is dependent upon future uncertain events
 - **Bharat Earth Movers(SC)** – AL must definitely arise in FY + incurring of the liability (even if on a future date) is certain
- **Do NOT Reduce CLs**
 - But reduce arrears of dividend on Cummulative Pref Shares

Valuation u/ R 11UA - Shares

- No adjustments for these A/L:
 - Investment in LLP / Firm / AOP: at Book Value only
 - IPRs on Book: Take at Book Value
 - P&M which have low realisable value: at Book Value only
 - Crypto Assets : Book Value only? Would Rule be amended to provide for FMV?
- If Co. is a loss making co which has valuable immovable property – No adjustment for future losses but IP @ SDRRV

Valuation u/ R 11UA-Shares

- Shares / Sec – How to value in case of Cross-held or Round-robin companies e.g., ***A holds B; B holds C and C holds A?***
 - Simultaneous Equations to be made?
- Valn of NBFCs / CICs
 - Bottom-up approach – first value lowest denominator & then move-up
- Unquoted Securities other than Eq Shs
 - Price it would fetch in open market as per Valn by CA / MB
 - Preference / Debentures / Convertibles
- Can AO Question the Valuation Report? Summon the CA?
 - Method Prescribed u/R to be strictly followed - no other Method can be selected – **Sharukh Khan (Bom)**

DVO

- No express provision in Rule 11UA nor in s.56(2)(x) for reference to DVO – compare with s.50C
- S.142A provided AO could for Asst. refer to DVO an estimate of value for any bullion / jewellery / investment or other valuable article u/s. 56(2)
- S.142A amended wef 1st Oct 2014. Now reads:
 - AO may for Asst/Reasst make reference to DVO to estimate the FMV of any Asset / Property / Investment
 - Specific reference to s.56(2) removed
 - Section very wide to cover all disputed valuation cases
 - DVO is a creature of the Act and bound by the Act and Rules and cannot deviate from them –**Bharat Hari Singhania (SC)**

S.56(2)(viib) – Issue of Shares

Where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares:

Provided *that this clause shall not apply where the consideration for issue of shares is received—*

- (i) by a venture capital undertaking from a venture capital fund; or*
- (ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf.*

Explanation.—*For the purposes of this clause,—*

- (a) the fair market value of the shares shall be the value—*
 - (i) as may be determined in accordance with such method as may be prescribed; or*
 - (ii) as may be substantiated by the company to the satisfaction of the AO, based on the value, on the date of issue of shares, of its assets, including intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature,*
whichever is higher;

S.56(2)(viib)

- FM's Speech while moving FB 2012

*"I propose a series of **measures to deter** the generation and use of **unaccounted money**. To this end, I propose:*

....taxing share premium in excess of fair market value."

- This Speech was held as one of the important aspects while determining whether Sec. was applicable - **Vani Estates P Ltd (Chen)**

S.56(2)(viib)

- Applies only to Issue of Shs to Residents – FDI not covered
 - *FinProject (I) P Ltd (Mum)*
- If Issue Price > FMV then Co taxed on the Excess Amount
- Issue to VCF / Issue by Start-ups > FMV = exempted
 - Notf. 45/2016 ~ Must be recognised as S/Up by DIPP Notf. 16 Jan 2019
- **Method of determining FMV – 3 Methods:**
 - DCF or Book Value Method – **Option of Co**
 - B/S Book Value and not Adjusted BV – no changes for Imm Prop / Shs / Art like in case of s.56(2)(x) – **unfair**
 - Value to satisfaction of AO based on Tangible Assets / IPR
 - Higher of above 2 methods is FMV

Angel Tax

- Angel Tax became a Devil for Cos & Investors
 - AO questioning the Valuation
 - Comparing DCF Projections vs Actual Numbers
 - Performance did not reach up to Projected Numbers = valuation disregarded
 - AOs have started questioning Valuers also
 - Sought explanation on Assumptions / Projections used in DCF Valuation by Investee Companies
 - 1/3rd of all Angel Investments in Start-ups have been Questioned over Valuation

S.56(2)(viib) – Angel Exemption

- **Start-up Notification dt 16th Jan 2019 for Angel Tax**
 - To claim exemption from s.56(2)(viib) provisions for S/Up
 - Aggregate Pd up cap + Sh. Premium post issue \leq Rs 10 cr.;
 - Angel investor has Returned Income \geq Rs 50 L during last yr and it has NetWorth \geq Rs 2 cr on last FY
 - **No MB Valuation required for such S/Ups – needed for others**
 - Application to CBDT routed via DIPP, Com. Ministry
 - CBDT would grant / decline within 45 days of receipt
 - AO cant take coercive measures by rejecting DCF of S/Ups –
CBDT Letter dt 6-2-2018

S.56(2)(viib) – Angel Exemption

◦ General Exemption

- Investments made @ Premium by
 - SEBI Registered AIF Cat-I: VCF / SME / Angel Funds
 - SEBI Registered AIF Cat-II: PE Funds
 - AIF Cat-I / II set up in GIFT City
- AIFs can also be set up as Family Offices
 - Can by-pass s.56(2)(viib) altogether
 - AIF-I and II taxable as Pass-through Entities
- **MB Valuation needed for cases not falling u/Notf. 16th Jan 2019**

Valuation – Judicial Precedents

- Revenue cannot reject valuation report without demonstrating that methodology adopted was not correct and without providing any alternate FMV of shares
- Challenging projections when not met with Actuals & rejecting valuation “*lacks material foundation and is irrational since valuation is intrinsically based on projections which can be affected by various factors*”;
- Valuation is “*not an exact science, ...cannot be done with arithmetic precision ... is a technical & complex problem which can be appropriately left to the consideration and wisdom of experts in the field of accountancy, having regard to the imponderables which enter the process of valuation of shares*”;
- Shares were subscribed to by outside investors and if they have seen certain potential and accepted this valuation, “*then Revenue cannot question their wisdom – Cinestaan Entertainment (Del HC)*”
- AO can’t insist on only NAV when Sec gives choice of selecting DCF– **Vodafone Mpesa (Bom)**

Valuation – Judicial Precedents

- AO can't substitute NAV when Sec gives choice of selecting DCF even if DCF widely varies from NAV – In hindsight if there is variance in Actuals and Projections cannot reject DCF – He can though question the basic assumptions and test them for reliability – But Method of Val is sole discretion of the assessee - **Credit Alpha Alternative Investment Advisors (Mum ITAT – Jan 2022)**

Valuation – Judicial Precedents

- DCF Valn report same as report for Bank Loan – Boom in sector justified Turnover rises – Promoters experienced– Plant capacity used as basis for projections – Earlier bottlenecks now overcome- No reason for rejecting DCF Report– 10% variation with valuation done by CIT(A) is fine – **(Jpr)**
- 2 Shareholders Mother & Daughter – Issue by Co to Mother @ High Premium of Rs. 23,000 since only she had Funds – post issue, SH% 75:25 – **Sec. introduced to curb Black Money** – 25% of Benefit of High Premium went from Mother to Daughter – She could have easily gifted funds to Daughter & then both could subscribe to Shs @ Face Value in which case Sec. would NA – **No Black Money generation in Family Cos** – Transfer under FS exempt even from CGT -- s.56(2)(viib) Held NA – **Vani Estates Ltd (Chen)**

Valuation – Judicial Precedents

- In Issue of CCPS – Valuation is to be done of Pref Shs not of Eq, ~ price in Open market as per MB / CA Report – **(Bang)**
- In scrutinizing valuation, data available on valuation date only to be considered - Actual result of projections cannot be a basis to decide about reliability of projections – **(Bang)**
- RPS also covered by section – However, if AO disputes Discounting Rate adopted by Valuer on an ad-hoc basis then Original valuation was upheld – **(Kol)** / DCF basis adopted by Co cannot be changed by AO – **(Bang)**

Valuation – Judicial Precedents

- Section NA to 2nd level subsidiary of a Listed Co. – **(Hyd)**
- Issue of shares @ Premium under Merger does not fall within the mischief of s.56(2)(viib) – **(Ahd)**
- FMV of Shares on BV basis –
 - Can consider Increase in Value of Land due to change from Agr to NA Use – Can factor in Share Valuation – **(Del ITAT)**
 - Can consider FMV / RRValue of Land – **Unnati Inorganics (Ahd)**
 - FMV of Land & Bldg cannot be substituted for NAV under this Method – **(Jpr)**

Sh. Valn. under 2 Sub-Sections

Factors	S.56(2)(x)		S.56(2)(viib)	
	EQUITY	PREF / CCD	EQUITY	PREF
Who can Value?	CA/ MB	CA/MB	MB only if DCF – CA / MB for NAV	CA / MB
Can it be Auditor?	Yes	Yes	No for NAV	Yes
Method to be followed	B/S NAV with Adj.	Any Method	B/S NAV without Adj OR DCF vs Asset – Higher	Any Method
Adjustments to be made?	Yes as specified	Can be made	No - B/s only	Can be made
B/S to be used	Dt of Receipt	Any	Dt of Receipt or Last Audited BS	Any

Sh. Valn. under 2 Sub-Sections

Factors	S.56(2)(x)		S.56(2)(viib)	
	EQUITY	PREF / CCD	EQUITY	PREF
Recipient holds shares as SIT	Exempt		<i>No Exemption</i>	
Shs Issued on Merger/Demerger	Expressly Exempt		<i>No Exemption</i>	
CCDs / OCDs		Covered	Not applicable	
Issue to Foreigner	Covered but taxable subject to Article on Other Income in DTAA		Exempt	

Thank You !!

www.ppsco.in
anup@ppsco.in