



## CBDT notifies Valuation Rules for unquoted equity shares and CCPS issued by Indian unlisted companies

Vide Notification No. 81/2023 dated September 25, 2023, the Central Board of Direct Taxes (**CBDT**) has notified amendment to Rule 11UA of the Income-tax Rule, 1962 (**Notified Rule**) for the purpose of Section 56(2) (viib) of the Income-tax Act, 1961 (**the Act**).

- Section 56(2) (viib) of the Act provides that in case an unlisted company receives any consideration for the issue of unquoted equity shares from any resident or non-resident exceeding the fair market value (**FMV**) of the shares, then such excess amount is taxable in the hands of such unlisted company (commonly known as **Angel Tax**).
- Earlier, the said provisions were applicable in case of shares issued to residents only. Finance Act 2023 extended the scope of applicability for shares issued to non-residents.
- In May 2023, CBDT vide Notification no. 29/2023 notified class of persons to whom Section 56(2)(viib) does not apply and further issued draft rules for public consultation.
- Key amendments:
  - Notified Rule recognise 5 new valuation methodologies to include globally accepted methodology for non-residents.
  - Such Rule also provides for mechanism for calculating FMV of compulsorily convertible preference shares (**CCPS**).
  - Safe harbour for unquoted equity shares and CCPS is available in cases where issue price does not exceed 10% of the FMV determined as per the Rules. Such Safe harbour is not applicable in cases where valuation corresponding to ‘Eligible Transactions’ (i.e., issue of shares ‘by VC Undertaking’ OR ‘to Notified entity’) has been adopted.
  - Notified Rule is applicable for transactions undertaken after September 25, 2023 (i.e., the date of notification).

### Summary - Valuation Rules for determining value of unquoted equity share

Methodologies	Applicability to investor	Erstwhile Rule	As per Notification 81/2023
Adjusted Net Asset Value Method (A-L) × [PV/PE]	Resident and Non-resident	<ul style="list-style-type: none"> <li>▪ No certification mandatory</li> <li>▪ Valuation date is the date of receipt of property/consideration.</li> </ul>	<ul style="list-style-type: none"> <li>▪ No change in valuation methodology</li> <li>▪ Valuation date is the date of receipt of property/consideration.</li> </ul>
Discounted Cash Flow Method	Resident and Non-resident	<ul style="list-style-type: none"> <li>▪ Certified by Merchant Banker</li> <li>▪ Valuation date is the date of receipt of property/consideration</li> </ul>	<ul style="list-style-type: none"> <li>▪ No change in valuation methodology</li> <li>▪ Option to deem valuation date as date of valuation report, where such report was issued within 90 days prior to the transaction.</li> </ul>

Comparable Company Multiple Method	Non-resident only	-	<ul style="list-style-type: none"> <li>▪ Certified by Merchant Banker</li> <li>▪ Option to deem valuation date as date of valuation report, where such report was issued within 90 days prior to the transaction.</li> </ul>
Probability Weighted Expected Return Method			
Option Pricing Method			
Milestone Analysis Method			
<b>Price Matching option</b>			
Shares issued by VC Undertaking within 90 days before or after issue of shares to VC Fund, VC company or Specified Fund.	Resident and Non-resident	-	<ul style="list-style-type: none"> <li>▪ FMV is the aggregate consideration received from a VC fund, VC Company or Specified fund.</li> </ul>
Shares issued by a company within 90 days before or after issue of shares to a notified entities as per Notification 29/2023	Resident and Non-resident	-	<ul style="list-style-type: none"> <li>▪ FMV is the aggregate consideration that is received from the notified entity.</li> </ul>

**Summary - Valuation Rules for determining value of CCPS**

Particulars	Valuation Methodology
Resident	Option to determine FMV of CCPS as per: <ul style="list-style-type: none"> <li>▪ DCF method or Price matching method (as indicated above); OR</li> <li>▪ Based on value of unquoted equity share determined as per aforementioned Rules.</li> </ul>
Non-resident	Option to determine FMV of CCPS as per: <ul style="list-style-type: none"> <li>▪ DCF method, Comparable Company Multiple Method, Probability Weighted Expected Return Method, Option Pricing Method, Milestone Analysis Method, Replacement Cost Methods or Price matching method (as indicated above); OR</li> <li>▪ Based on value of unquoted equity share determined as per aforementioned Rules.</li> </ul>



## ELP Comments

- *Mechanism for valuation of CCPS has now been prescribed. This aspect was not a part of the draft Rules issued for public consultation. While the Rules prescribe valuation methodology for CCPS, no valuation methodology has been prescribed for issue of OCPS and RPS. Given the absence of valuation methodology for OCPS/RPS, the issue regarding applicability of Section 56(2)(viib) to OCPS/RPS and relevant valuation methodology, still remains ambiguous.*
- *While the valuation date in case of Adjusted Net Asset Value method remains unchanged, flexibility has been extended by allowing use of valuation report issued 90 days prior to the date of transaction in case of Merchant Banker valuation.*
- *Benefit of Price Matching has been extended in case of share issue transaction undertaken before or after 90 days of 'Eligible Transactions'. Practically, such benefit would be availed only in specific scenarios like share issue succeeding a VC investment/notified investment OR investments which involve other parties are making investments along with VCC, VCF, specified or notified entities. It would be impractical to avail such benefit in case of share issue where visibility of future Eligible Transaction may not exist.*
- *Extending safe harbour to Angel Tax is a welcome move and appears to be in line with the safe harbour extended to immovable property transactions.*
- *In case of joint investments by resident and non-resident, it may not be practically feasible to adopt 5 new valuation methods as doing so would lead to multiple valuations.*

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at [insights@elp-in.com](mailto:insights@elp-in.com) or write to our authors:

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