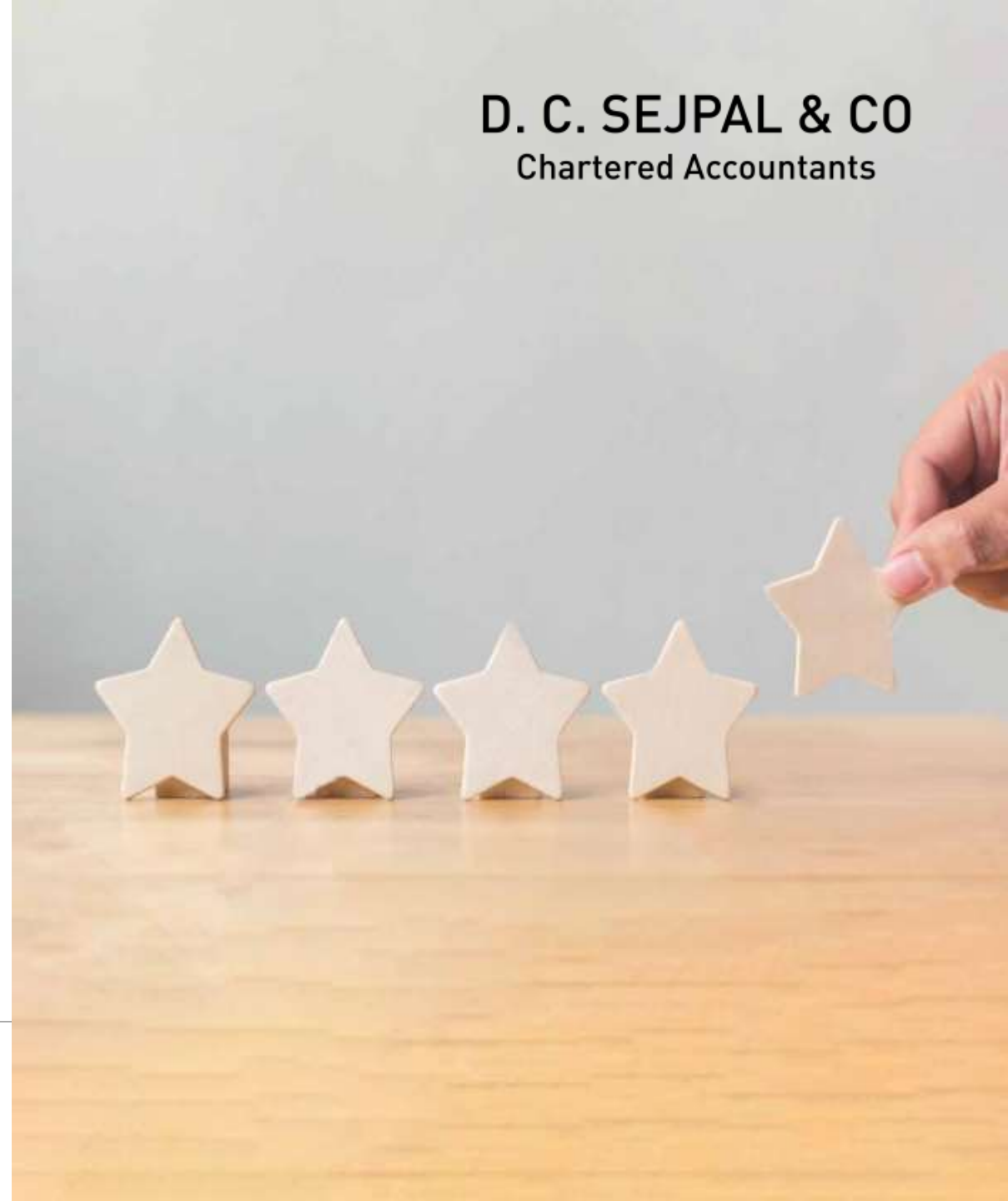


56(2)

Taxability on Issue, Transfer of Shares of Private Limited Companies





INDEX

SR. No.	Content	Slide Number
1	Background	5-6
2	Which sections under IFOS trigger?	7
3	Introduction of section 56 (2) (viib)	8 - 12
4	Impact of amendment by FA 2023	13-14
5	Issue of Shares – Section 56(2)(viib)	15-17
6	Overview of section 56(2)(viib)	18
7	Eligible Startup	19-24
8	Why Amendment	25
9	Background pf Section 56(2)(vii), (viia) and 56(2)(x)	26-27
10	Old Provisions vs. New Provisions	28
11	Introduction of section 56 (2)(x)	29-34
12	Categories of section 56(2)(x)	35-39



INDEX

SR. No.	Content	Slide Number
13	Issue of Shares – Section 56(2)(x)	40-41
14	Fair Market Value	42
15	Rules for determining FMV	43-47
16	Difference in Valuation Method	48
17	Challenges in Implementation of Rules – Section 56(2)(viib) and 56(2)(x)	49
18	Impact of section 56(2) on certain structures along with interplay with other sections	50
	- Buy Back	51-56
	- Family Settlements	57-59
	- Section 50CA and Section 56(2)(x)	60-63
19	Case Studies	64-70



Acknowledgement

Team

- **Roshni Menat;**
- **Ashwini Nair**

Thank you team for supporting me in this endeavour



Background (1/2)

- Gift Tax Act, 1957 - applicable to gifts made on or after 01.04.1957.
- Finance (No. 2) Act, 1998 abolished the Gift Tax Act, 1957 and proposed to tax value of any movable or immovable property received on or after 01.10.1998 by any person without consideration in money or money's worth as income.
- S. 56(2)(v) introduced by Finance (No. 2) Act, 2004 - applicable to any sum of money received without consideration ("gifts") made on or after 01.09.2004, forgives gifts until 31.03.2006.
- S. 56(2)(vi), introduced by Taxation Laws (Amendment) Act, 2006, replaced S. 56(2)(v) - applicable to gifts made on or after 01.04.2006 upto 30.09.2009
- S. 56(2)(vii), introduced by Finance (No. 2) Act, 2009, replaced S. 56(2)(vi) - applicable to gifts made on or after 01.10.2009. Property in kind also covered.
- S. 56(2)(viiia), introduced by Finance Act, 2010 - applicable to firms or closely held companies receiving shares of closely held companies, on or after 01.06.2010, without consideration or for inadequate consideration.



Background (2/2)

- Rules 11U and 11UA notified on 07.04.2010 w.e.f. 01.10.2009 for determination of fair market value of the property other than immovable property - Valuation Rules for S. 56(2)(vii) and 56(2)(viia).
- S. 56(2)(viib) introduced by Finance Act, 2012, w.e.f. 01.04.2013 - applicable to closely held companies receiving consideration for issue of shares in excess of FMV of the shares.
- S. 56(2)(viib) amended by Finance Act, 2013, w.e.f. 01.04.2014 - Considering the fact that there may be a time gap between the date of agreement and the date of registration, the stamp duty value may be taken as on the date of the agreement, instead of that on the date of registration.
- S. 56(2)(vii) and 56(2)(viia) is not applicable w.e.f. 01.04.2017.
- S. 56(2)(x) introduced by Finance Act, 2017, w.e.f. 01.04.2017 –A new clause (x) has been inserted so as to provide that receipt of the sum of money or the property by any person without consideration or for inadequate consideration in excess of Rs. 50,000 shall be chargeable to tax in the hands of the recipient under the head "Income from other sources".



Which sections under IFOS trigger with respect to transactions of shares?

Section 56(2)(viib)

Section 56(2)(x)



Section 56 (2)(viib) (1/5)

- Introduced in 2012 by the UPA Government
- Issued under “Measures to prevent generation and circulation of unaccounted money”
- Taxes as income any capital receipt in “excess” of the fair market value of the securities issued by a private company
- Has become an “angel tax” on capital raised by startups only from Indian domestic investors, not foreign investors. Though, this anomaly has been addressed with the amendment by the Finance Act 2023



Section 56 (2)(viib) (2/5)

'(viib) where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person ^{24a}[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 company or a venture capital fund or a specified fund; or*
- (ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf:*

Provided further that where the provisions of this clause have not been applied to a company on account of fulfilment of conditions specified in the notification issued under clause (ii) of the first proviso and such company fails to comply with any of those conditions, then, any consideration received for issue of share that exceeds the fair market value of such share shall be deemed to be the income of that company chargeable to income-tax for the previous year in which such failure has taken place and, it shall also be deemed that the company has under reported the said income in consequence of the misreporting referred to in sub-section (8) and sub-section (9) of section 270A for the said previous year.



Section 56 (2)(viib) (3/5)

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 prescribed²⁵; or

(ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, 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;

25 – See rules 11U and 11UA



Section 56 (2)(viib) (4/5)

(aa) "specified fund" means a fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) ²⁶[or regulated under the ²⁷[International Financial Services Centre Authority (Fund Management) Regulations, 2022 made under the] International Financial Services Centres Authority Act, 2019 (50 of 2019)];

(ab) "trust" means a trust established under the Indian Trusts Act, 1882 (2 of 1882) or under any other law for the time being in force;

(b) "venture capital company", "venture capital fund" and "venture capital undertaking" shall have the meanings respectively assigned to them in clause (a), clause (b) and clause (c) of Explanation to clause (23FB) of section 10;



Section 56 (2)(viib) (5/5) - Ingredients

The ingredients of this provision after amendment are as under:

- (a) It applies to a **closely held company**;
- (b) It must **receive any consideration** for the **issue of shares**;
- (c) Such consideration is received **from any person**;
- (a) The issue price of shares exceeds the face value of such shares;
- (e) The aggregate consideration received for such shares exceeds the fair market value of the shares.

If the above conditions are satisfied, the consideration in excess of the fair market value of the shares is considered income from other sources. It would be taxable in the hands of the company issuing the shares. Notwithstanding the amendment to clause (viib), the exceptions outlined in the proviso to Section 56(2) (vib) will remain in effect for shares issued by venture capital undertakings, other notified persons, and eligible start-ups.



Impact of amendment in FA 2023 (1/2)

Hitherto, Section 56(2)(vib) did not apply to the consideration received from the non-resident investors. The amendment has omitted the phrase "being a resident" from clause (vib) and broadened its scope to cover consideration received from non-residents. Now, the provision applies to the consideration received from anyone regardless of his residency status.

For example, XYZ Pvt. Ltd. issued 1,000 equity shares of a face value of Rs. 10 each at a premium of Rs. 990 to a non-resident investor. The fair market value of a share is Rs. 600, Thus, the aggregate fair market value of 1,000 shares is Rs.0 lakhs. The excess consideration of Rs. 4 lakhs received for the issue of shares will be taxable in the hands of XYZ Pvt. Ltd. under Section 56(2) (viib).

The amendment overcomes the following rulings:

- (a) Provisions of Section 56(2) (viib) are not applicable to the consideration received from non-residents for issuing shares [Ruchi J Oil (P.) Ltd. v. PCIT [2021] 129 [taxmann.com](https://www.taxmann.com) 432 (Indore - Trib.)];
- (b) Where the assessee had received share application money from non-residents, provisions of Section 56(2) (vib) would not apply [EduLink (P.) Ltd. v. ITO [2019] 108 [taxmann.com](https://www.taxmann.com) 221/178 ITD 174 (Bang. - Trib.)].



Impact under FEMA (2/2)

An Indian company is permitted to issue fresh shares to a person resident outside India under the FDI Scheme, subject to compliance with the prevailing FDI policy and FEMA Regulations. Such an issue of shares must adhere to the pricing guide- lines, valuation norms, and reporting requirements, among other requirements, as prescribed under the FEMA Regulations. For unlisted companies, shares issued to a person resident outside India under the FDI Scheme must not be valued below the fair value of shares, determined by a SEBI registered Merchant Banker or a Chartered Accountant using any internationally accepted valuation methodologies.

Under the Income-tax Act, shares must be issued at or below the FMV to avoid taxation under Section 56(2) (vib). In contrast, under FEMA, the shares must be issued at a minimum of FMV, and the issue of shares below FMV is not permissible. As long as the issue price matches the FMV, the company can comply with the Income-tax Act and FEMA pricing regulations. However, practically, the infusion and pricing of equity shares in investment rounds are typically determined through independent negotiations between the parties involved.



Issue of Shares – Income Tax – S. 56(2)(viib) (1/3)

Fair market value of the shares shall be the value—

- Rule 11UA –
 - book value – unadjusted for fair value of specified property or
 - Discounted Cash Flow Method – merchant bankers report
- Alternative – to justify the price to AO based on value of assets including intangible assets



Issue of Shares – Income Tax – S. 56(2)(viib) – press release (2/3)

❑ Rule 11UA – for non-resident (press release – 19-May-23) – Key takeaways

- It is proposed to include 5 more valuation methods, available for non-resident investors, in addition to the DCF and NAV methods of valuation.
- Issue of shares to notified entities – will be the base for shares issued to R and NR in the time frame of 90 days
 - o Similar lines, price matching for resident and non-resident investors would be available with reference to investment by Venture Capital Funds or Specified Funds
- Valuation – upto 90 days prior to the issue would be acceptable
- **Safe harbour of 10 % variation in value.**



Issue of Shares – Income Tax – S. 56(2)(viib) – press release (3/3)

❑ Excluded entities

- Government and Government related > 75% Govt. ownership
- Banks and Insurance Companies
- Resident of a certain countries or specified territories having robust regulatory framework:-
 - Entities registered with SEBI as Category-I Foreign Portfolio Investors.
 - Endowment Funds associated with a university, hospitals or charities,
 - Pension Funds
 - Broad Based Pooled Investment Vehicle or Fund > 50 investors. Not a hedge fund or a fund which employs diverse or complex trading strategies.
- DPIIT registered start-up – notification to be amended to include investment from non-resident



Overview of 56(2)(viib)

The taxability of share premium in excess of the fair market value of the shares after the amendment is summarised in the table below:

Issuing Company	Shares issued to	Whether Section 56(2) (viib) is applicable?
Venture Capital Undertaking	Venture Capital Company	No
	Venture Capital Fund	No
	Category-I or Category-II AIF	No
Eligible startup	Any person (in compliance with DPIIT Notification)	No
	Any person (In any other case)	Yes
Closely held company not being an eligible startup	Any person (Being Resident or Non-resident)	Yes (If the issue price is more than FMV)



Notified class of persons under clause (ii) of proviso to section 56(2) (viib) (1/6)

In exercise of the powers conferred by clause (it) of the proviso to clause (viib) of sub-section (2) of section 56 of the Income-tax Act, 1961 and in supersession of the notification of Government of India in the Ministry of Finance, Department of Revenue, Central Board of Direct Taxes published in the Gazette of India, Extraordinary, Part-II, section (3), sub-section (in) vide number SO 2088 (E), dated 24th May, 2018, except as respect things done or omitted to be done before such supersession, the Central Government, hereby notifies that the provisions of clause (viib) of sub-section (2) of section 56 of the said Act shall not apply to consideration received by a company for issue of shares that exceeds the face value of such shares, if the said consideration has been received from a person, being a resident, by a company which fulfils the conditions specified in para 4 of the notification number CSR. 127(E), dated the 19th February, 2019 issued by the Ministry of Commerce and Industry in the Department For Promotion of industry and Internal Trade and published in the Gazette of India, Extraordinary, Part:I section 3 Subsection () on 19th February, 2019 (See section 80-IAC) 25d files the declaration referred to in para 5 of the said notification of the Department for Promotion of Industry and Internal Trade.

This notification shall be deemed to have come into force retrospectively from the **19th February, 2019. - Notification No. SO 1131(E), dated 5-3-2019.**



Exemption for the purpose of clause (viib) of sub-section (2) of section 56 of the Act (2/6)

A Startup shall be eligible for notification under clause (ii) of the proviso to clause (viib) of sub section (2) of section 56 of the Act and consequent exemption from the provisions of that clause, if it fulfils the following conditions :

- (i) it has been **recognised by DPIIT** under para 2(in) (a) or as per any earlier notification on the subject;
- (ii) aggregate amount of paid up share capital and share premium of the startup **after issue** of proposed issue of share, if any, **does not exceed, twenty five crore rupees** :

Provided that in computing the aggregate amount of paid up share capital, the amount of paid up share capital and share premium of twenty five crore rupees in respect of shares issued to any of the following persons shall not be included-

(a) a non-resident; or

(b) a venture capital company or a venture capital fund:

Provided further that considerations received by such startup for shares issued or proposed to be issued to a specified company shall also be exempt and shall not be included in computing the aggregate amount of paid up share capital and share premium of twenty five crore rupees.



Exemption for the purpose of clause (viib) of sub-section (2) of section 56 of the Act (3/6)

(iii) It has **not invested** in any of the following assets,

(a) building or land appurtenant thereto, being a residential house, other than that used by the Startup for the purposes of renting or held by it as stock-in-trade, in the ordinary course of business;

(b) land or building, or both, not being a residential house, other than that occupied by the Startup for its business or used by it for purposes of renting or held by it as stock-in-trade, in the ordinary course of business;

(c) loans and advances, other than loans or advances extended in the ordinary course of business by the Startup where the lending of money is substantial part of its business;

(d) capital contribution made to any other entity;

(e) shares and securities;

(f) a motor vehicle, aircraft, yacht or any other mode of transport, the actual cost of which exceeds ten lakhs rupees, other than that held by the Startup for the purpose of plying, hiring, leasing or as stock-in-trade, in the ordinary course of business;

(g) jewellery other than that held by the Startup as stock-in-trade in the ordinary course of business;

(h) Any other asset, whether in the nature of capital asset or otherwise, of the nature specified in sub-clause (iv) to (ix) of clause (d) of explanation to clause (vii) of section (2) of section 56 of the Act

Provided that the Startup shall not invest in any of the assets specified in sub clause, (a) to (h) for the period of seven years from the end of the latest financial year in which shares are issued at premium.



Exemption for the purpose of clause (viib) of sub-section (2) of section 56 of the Act (4/6)

Explanation. For the purposes of this paragraph,

(i) specified company^o means a company whose shares are frequently traded within the meaning of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and whose net worth on the last date of financial year preceding the year in which shares are issued exceeds one hundred crore rupees or turnover for the financial year preceding the year in which shares are issued exceeds two hundred fifty crore rupees.

(in) the expressions "venture capital company" and "venture capital fund" shall have the same meanings as respectively assigned to them in the Explanation to clause (viib) of sub-section (2) of section 56 of the Act.



Consolidated circular for assessment of Startups (6/6)

In order to provide hassle-free tax environment to the Startups, a series of announcements have been made by the Hon'ble Finance Minister in her Budget Speech of 2019 and also on 23rd August, 2019. To give effect to these announcements, the Central Board of Direct Taxes (CBDT) has issued various circulars/clarifications in the matter. This circular consolidates all these circulars and further clarifies as under;-

- Circular No. 16/2019 [F.No. 173/149/2019-ITA-I], dated 7-8-2019
- Clarification Notification dated 09.08.2019
- DCIT Corporate Circle 1 vs. Kovai Media P. Ltd, Coimbatore (I.T.A. No. 1562/Chny/2019 & C.O.No.83/Chny/2019)

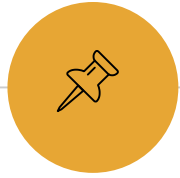


WHY AMENDMENT ?

Introduction of Section 56(2)(x)

- The Memorandum explaining the provisions of the Finance Bill states as under :
“The existing definition of the property for the purpose of this section includes immovable property, jewellery, shares, painting, etc. These anti-abuse provisions are applicable only in case of individual or HUF and firm or company in certain cases. Therefore, receipt of sum of money or property without consideration or for inadequate consideration does not attract these anti-abuse provisions in case of other assessee.”

- Thus, it appears that through insertion of new provision, the scope of the existing anti-abuse provision is widened to make it applicable to all assessees and also clubbing section 56(2)(vii) & section 56(2) (viiia).



Old provisions vs New provision

Section	Received From	Persons Covered	Amount	Period
56(2)(vii)	Any Person	Individuals or HUF	<p>Any sum of money, immovable property and any property other than immovable property</p> <ul style="list-style-type: none"> Without consideration if the aggregate FV > 50,000 → then the FV is taxable under IFOS. For Consideration if the consideration < Aggregate FMV & the FMV > 50,000 → then the amount of FV - Consideration is taxable. 	On/after 01/06/2010 to 01/04/2017
56(2) (viiia) Finance Act 2009	Any Person	Firms/ Closely held Company	<p>Shares of closely held company</p> <ul style="list-style-type: none"> Without consideration if the aggregate FV > 50,000 → then the FV is taxable under IFOS. For Consideration if the consideration < Aggregate FMV & the FMV > 50,000 → then the amount of FV - Consideration is taxable. 	



Old provisions vs New provision

Section	Received From	Persons Covered	Amount	Period
56(2)(x) Introduced by Finance Act 2017	Any Person (The receipts must be received on or after 1/4/2017)	Covers all categories of person (including listed and widely held companies)	<ul style="list-style-type: none"> Without consideration if the aggregate FV > 50,000 → then the FV is taxable under IFOS. For Consideration if the consideration < Aggregate FMV & the FMV > 50,000 → then the amount of FV - Consideration is taxable. 	Effective from 01/04/2017 onwards

Section 56(2)(x) is verbatim reproduction of section 56(2)(vii), with the intention of having 56(2)(x) a wider implication.

Thus, all the provisions relating to referring the valuation to DVO in case of immovable property and in relation to the relevant date to be taken for ascertaining the Stamp duty value in case where the date of registration and date of agreement is different have been retained in the new section also. Even the definition of the terms including that of “relative” and “property” has been retained in the new clause also.



Section 56(2)(x) of the Act (1/6)

(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,—

(A) without consideration, the stamp duty value of which exceeds fifty thousand rupees, the stamp duty value of such property;

(B) for a consideration, the stamp duty value of such property as exceeds such consideration, if the amount of such excess is more than the higher of the following amounts, namely:—

(i) the amount of fifty thousand rupees; and

(ii) the amount equal to ten per cent of the consideration:



Section 56(2)(x) of the Act (2/6)

Provided that where the date of agreement fixing the amount of consideration for the transfer of immovable property and the date of registration are not the same, the stamp duty value on the date of agreement may be taken for the purposes of this sub-clause:

Provided further that the provisions of the first proviso shall apply only in a case where the amount of consideration referred to therein, or a part thereof, has been paid by way of an account payee cheque or an account payee bank draft or by use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed²⁸, on or before the date of agreement for transfer of such immovable property:

Provided also that where the stamp duty value of immovable property is disputed by the assessee on grounds mentioned in sub-section (2) of section 50C, the Assessing Officer may refer the valuation of such property to a Valuation Officer, and the provisions of section 50C and sub-section (15) of section 155 shall, as far as may be, apply in relation to the stamp duty value of such property for the purpose of this sub-clause as they apply for valuation of capital asset under those sections:



Section 56(2)(x) of the Act (3/6)

***Provided also** that in case of property being referred to in the second proviso to sub-section (1) of section 43CA, the provisions of sub-item (ii) of item (B) shall have effect as if for the words "ten per cent", the words "twenty per cent" had been substituted;]*

(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:



Section 56(2)(x) of the Act (4/6)

Provided that this clause shall not apply to any sum of money or any property received—

- (I) from any relative; or*
- (II) on the occasion of the marriage of the individual; or*
- (III) under a will or by way of inheritance; or*
- (IV) in contemplation of death of the payer or donor, as the case may be; or*
- (V) from any local authority as defined in the Explanation to clause (20) of section 10; or*
- (VI) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or*
- (VII) from or by any trust or institution registered under section 12A or section 12AA or section 12AB; or*
- (VIII) by any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of section 10; or*
- (IX) by way of transaction not regarded as transfer under clause (i) or clause (iv) or clause (v) or clause (vi) or clause (via) or clause (viaa) or clause (vib) or clause (vic) or clause (vica) or clause (vicb) or clause (vid) or clause (vii) ³⁰[or clause (viiac) or clause (viiad) or clause (viiac) or clause (viiad) or clause (viiac) or clause (viiad) or clause (viiac) or clause (viiad)] of section 47; or*



Section 56(2)(x) of the Act (5/6)

- (X) from an individual by a trust created or established solely for the benefit of relative of the individual;*
 - (XI) from such class of persons and subject to such conditions, as may be prescribed³¹;*
 - (XII) by an individual, from any person, in respect of any expenditure actually incurred by him on his medical treatment or treatment of any member of his family, for any illness related to COVID-19 subject to such conditions, as the Central Government may, by notification in the Official Gazette, specify in this behalf;*
 - (XIII) by a member of the family of a deceased person, —*
 - (A) from the employer of the deceased person; or*
 - (B) from any other person or persons to the extent that such sum or aggregate of such sums does not exceed ten lakh rupees,*
- where the cause of death of such person is illness related to COVID-19 and the payment is—*
- (i) received within twelve months from the date of death of such person; and*
 - (ii) subject to such other conditions, as the Central Government may, by notification in the Official Gazette, specify in this behalf.*



Section 56(2)(x) of the Act (6/6)

(Explanation.—For the purposes of clauses (XII) and (XIII) of this proviso, "family", in relation to an individual, shall have the same meaning as assigned to it in Explanation 1 to clause (5) of section 10:]

Provided further that clauses (VI) and (VII) of the first proviso shall not apply where any sum of money or any property has been received by any person referred to in sub-section (3) of section 13.

Explanation.—For the purposes of this clause,—

- (a) the expressions "assessable", "fair market value", "jewellery", "relative" and "stamp duty value" shall have the same meanings as respectively assigned to them in the Explanation to clause (vii); and*
- (b) the expression "property" shall have the same meaning as assigned to it in clause (d) of the Explanation to clause (vii) and shall include virtual digital asset;*



Section 56(2)(x) (1/5)

The provisions of Section 56(2)(x) are sub-divided into the following 5 board categories:-

Category	Particulars	Transactions to be taken into account	Tax Treatment
Category 1 [s. 56(2)(x)(a)]	(i) Receipt of any sum of money without consideration; (ii) Aggregate value of such receipt during the previous year exceeds Rs. 50,000	All transactions to be taken into account	Whole of the aggregate value of such sum shall become taxable
Category 2 [s. 56(2)(x)(b)(A)]	(i) Receipt of any immovable property without consideration; (ii) Stamp Duty value of such property exceeds Rs. 50,000	Single transactions to be taken into account	SDV of such immovable property shall become taxable



Section 56(2)(x) (2/5)

The provisions of Section 56(2)(x) are sub-divided into the following 5 board categories:-

Category	Particulars	Transactions to be taken into account	Tax Treatment
Category 3A [s. 56(2)(x)(b)(B)]	<ul style="list-style-type: none"> (i) Receipt of any immovable property without consideration (other than a residential unit referred to in category 3B below); (ii) Difference between SDV of such property and consideration is more than Rs. 50,000; and (iii) SDV of exceeds 110% of the consideration 	Single transactions to be taken into account	SDV of such immovable property (-) Consideration paid or payable
Category 3B [4th proviso to s. 56(2)(x)(b)(B)]	<ul style="list-style-type: none"> (i) Receipt of a residential unit [ie. an independent housing unit with separate facilities for 	Single transactions to be taken into account	SDV of such immovable property (-) Consideration paid or payable



Section 56(2)(x) (3/5)

The provisions of Section 56(2)(x) are sub-divided into the following 5 board categories:-

Category	Particulars	Transactions to be taken into account	Tax Treatment
	living, cooking and sanitary requirement, distinctly separated from other residential units within the building, which is directly accessible from an outer door or through an interior door in a shared hallway and not by walking through the living space of another household] for a consideration; (ii) Transfer of such residential unit took place between 12-11-2020 and 30-6-2021;		



Section 56(2)(x) (4/5)

The provisions of Section 56(2)(x) are sub-divided into the following 5 board categories:-

Category	Particulars	Transactions to be taken into account	Tax Treatment
	<p>(iii) Such transfer is by way of first time allotment of residential unit to any person;</p> <p>(iv) Consideration received or accruing as a result of such transfer to the seller does not exceed Rs. 2 crores;</p> <p>(v) Difference between SDV of such property and consideration (paid or payable) is more than Rs. 50,000; and</p> <p>(vi) SDV exceeds 120% of the Consideration</p>		



Section 56(2)(x) (5/5)

The provisions of Section 56(2)(x) are sub-divided into the following 5 board categories:-

Category	Particulars	Transactions to be taken into account	Tax Treatment
Category 4 [s. 56(2)(x)(c)(A)]	(i) Receipt of any specified movable property without consideration; (ii) Aggregate FMV of such property exceeds Rs. 50,000	All transactions to be taken into account	Whole of such aggregate FMV of such property shall become taxable
Category 5 [s.56(2)(x)(c)(B)]	(i) Receipt of any specified movable property for a consideration; and (ii) Such consideration is less than Aggregate FMV of such property by an amount exceeding Rs. 50,000	All transactions to be taken into account	Aggregate FMV of such movable property (-) Consideration paid or payable



Issue of Shares - Income Tax S. 56(2)(x) (1/2)

1. S 56 (2)(x) - receipt of shares or securities without consideration or inadequate consideration as compared to the fair market value.
 - Circular No 3 2019 Dated 21 1 2019
2. Applicability to Issue of shares
 - Circular No 3 2019 Dated 21 1 2019
 - Sudhir Menon HUF v ACIT (2014) 45 taxmann.com 176 (Mum-Trib.) - against
 - Analogy Khoday Distilleries Ltd v CIT [2009] 307 ITR 312 (SC)



Issue of Shares - Income Tax S. 56(2)(x) (2/2)

3. Right Issue -

- Subscription limit to applicant's shares - Sudhir Menon HUF v ACIT [2014] 148 ITD 260 (Mum Trib.)
- Others do not subscribe and consequential increase in shareholding - Jigar Jashwantlal Shah v. ACIT [2022] 142 taxmann.com 200 (Ahmd-T)
- Right assigned by 3rd party - Jigar Jashwantlal Shah v ACIT [2022] 142 taxmann.com 200 (Ahmd-T)
- Disproportionate allotment within family - Kumar Pappu Singh v. DCIT [2019] 174 ITD 465 (Visakhapatnam-Trib)

4. Bonus Shares –DCIT v. Dr. Rajan Pai [2016] 48 ITR(T) 170 (Bangalore-Trib)

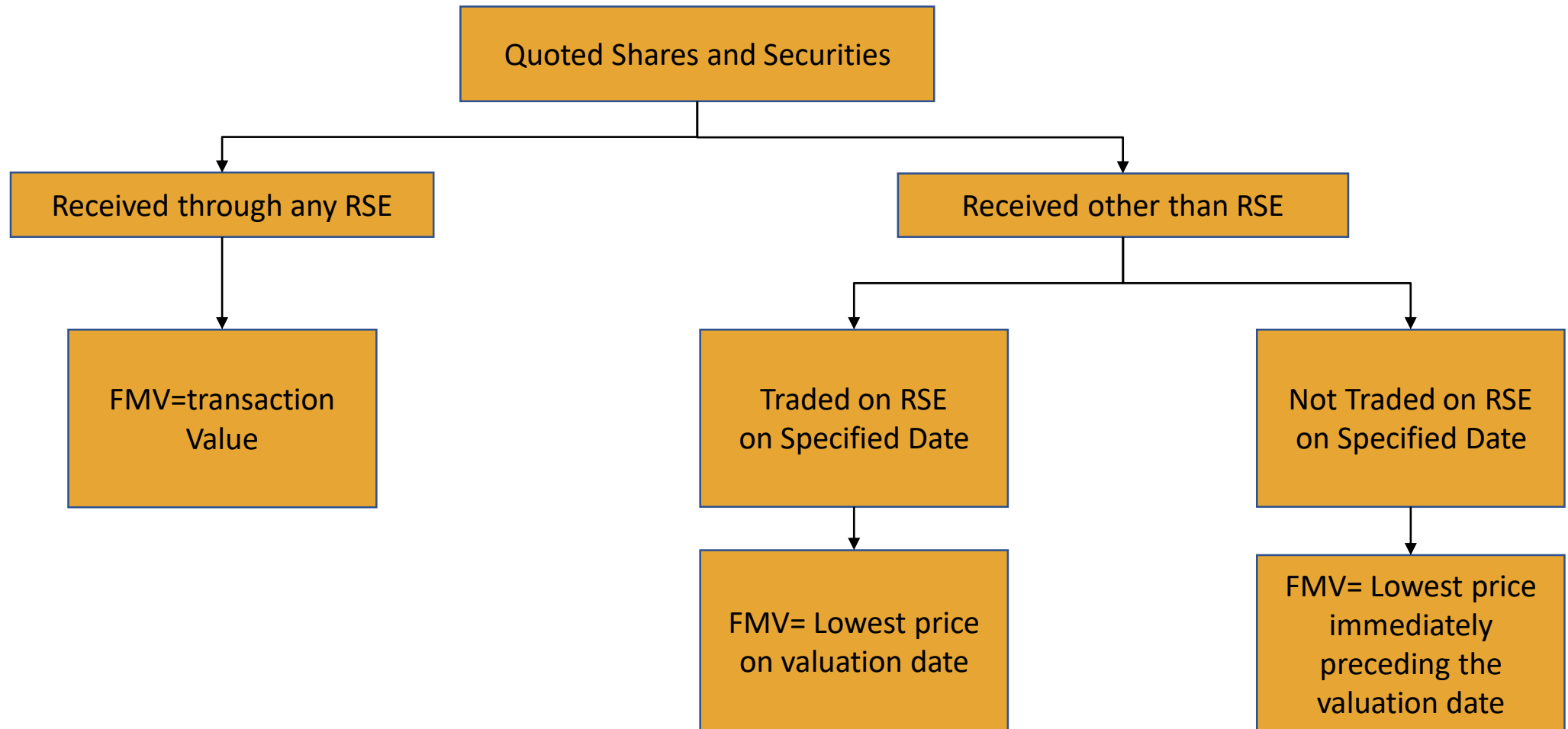


FAIR MARKET VALUE

- Fair Market value of a property other than an immovable property means the value determined in accordance with the method as may be prescribed
- New rule- w.e.f from FY 17-18
- Considers adjusted Net Asset value Method with certain assets on FMV and remaining asset based on book value
- Rule 11U- Meaning of Expression used in determination of FMV
- Rule 11 UA- Valuation of jewellery , archaeological collections, drawings, paintings , sculptures or any work of art, shares & Securities.

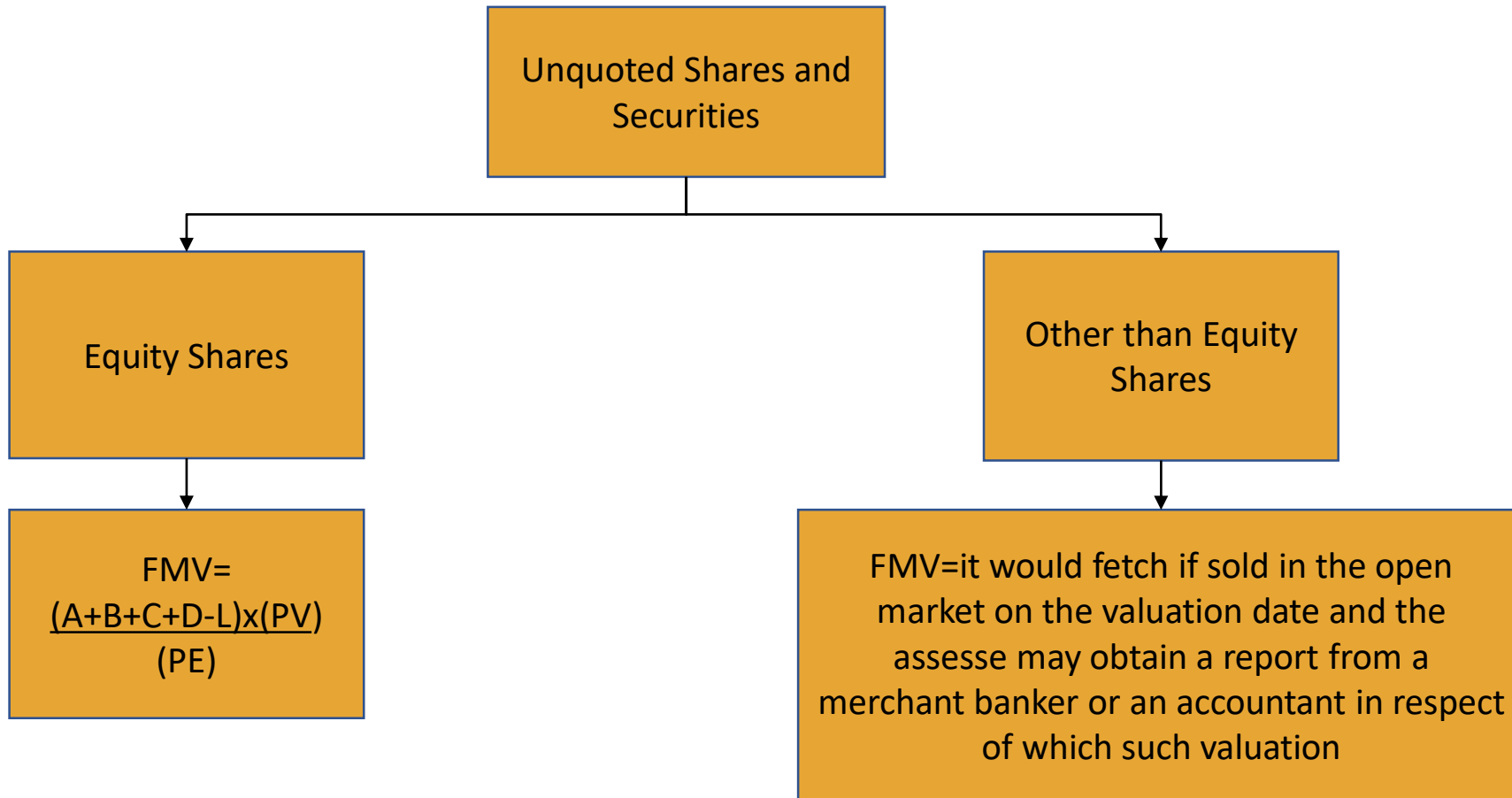


RULES FOR DETERMINING FMV (1/5)





RULES FOR DETERMINING FMV (2/5)





RULES FOR DETERMINING FMV (3/5)

Note:

A = Book value of the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance-sheet as reduced by,—

- I. any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any; and
- II. any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset.

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



RULES FOR DETERMINING FMV (4/5)

Note:

L = book value of liabilities shown in the balance sheet, but not including the following amounts, namely:—

- I. the paid-up capital in respect of equity shares;
- II. 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;
- III. reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
- IV. any amount representing provision for taxation, other than 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;



RULES FOR DETERMINING FMV (5/5)

Note:

- v. any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
- vi. any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PV = the paid up value of such equity shares;

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



Difference in Valuation Method

The difference in method of valuation of equity shares u/s 56(2)(viib) and 56(2)(x) can be tabulated 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 shares	Any person receiving the share or security
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, NAV method not prescribed	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.



Issue of Shares - Income Tax S. 56(2)(x)

Audited Balance Sheet-

- 56(2)(viib) - on the date of valuation or last approved balance sheet.?
- S. 56 (2)(x) - No clarity on how audited financials are to be obtained particularly, problematic for a minority shareholder
- Last audited balance sheet - Jigar Jashwantlal Shah v ACIT [2022] 142 taxmann.com 200 (Ahmd-T)

Rule 11UA –

- Immovable property - book value is higher value ?
- Crossholding
- Negative net worth of companies in which investments are done - restrict to zero ?
- Income tax paid under protest - to be excluded ?



Impact of Section 56(2) on certain structures along with interplay with other section.



Application of Section 56(2)(viiia)/56 (2) (x) in case of Buy Back (1/6)

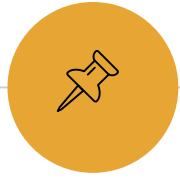
- ❑ Buyback at less than Rule 11UA value – 56(2)(x), 50CA and GAAR ?
 - 56(2)(x) – Not a capital asset
 - Commercial Tax Officer & Ors vs State Bank Of India [2016] 11 TMI 416 (SC);
 - Vora Financial Services P. Ltd. v. ACIT [2018] TS 346 (Mum Trib) – Similar view in DCIT v. TPS Infrastructure Ltd (ITA.No.6433/Del/2018) and VITP (P.) Ltd v. DCIT [2022] 143 taxmann.com 304 (Hyderabad - Trib.)
- ❑ S. 10(34A) – exempts income in the hands of shareholders
 - S. 50CA? - no implication
 - If no buyback tax is payable by the Company, is exemption still available to shareholder u/s 10(34A)?
 - Covers dividend, capital gains, business income?
 - ***“any income arising to an assessee, being a shareholder, on account of buy back of shares by the company as referred to in section 115QA”***



Application of Section 56(2)(viiia)/56 (2) (x) in case of Buy Back (2/6)

- ❑ S. 115QA – tax @ 23.30% (20% plus 12% surcharge plus 4% cess) in the hands of domestic companies on distributed income on buy-back
 - **Effective tax rate 18.9%** ($23.30/123.30$)
 - Distributed income = amount distributed less amount received on issue (complex formula for determining the amount received)

- ❑ Identification of shares ?
 - Rule 40BB – demat shares and the same cannot be distinctly identified – FiFo Method
 - Convert from demat shares to physical shares ?



Application of Section 56(2)(viiia)/56 (2) (x) in case of Buy Back (3/6)

- ❑ Proportionate buy-back at less than fair value ?
- ❑ Buyback of foreign company shares
 - Risk of 2(22) ?
 - ○ *“dividend” does not include . . . any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956 (1 of 1956)*
- ❑ Buyback at inflated price – dividend v. buyback
 - Fidelity Business Services India Pvt. Ltd. v. ACIT [2018] 95 taxmann.com 253 (Karnataka HC) Buy back price paid by the assessee to its wholly owned holding company does not represent true fair market price of the share of the assessee then it is nothing but a dubious method of avoiding the tax in the garb of buy back



Application of Section 56(2)(viiia)/56 (2) (x) in case of Buy Back (4/6)

- ❑ Companies Act – threshold of 25% - quantum or number of shares
 - *“the buy-back is twenty-five per cent or less of the aggregate of paid-up capital and free reserves of the company: Provided that in respect of the buy-back of equity shares in any financial year, **the reference** to twenty-five per cent in this clause shall be construed with respect to its **total paid - up equity capital** in that financial year”*
- Report of the Company Law Committee March 2022 –
 - *As such, the Committee was of the opinion that ‘free reserves’ are to be included in the calculation of buy-back of equity shares, even if the term has not been specifically included in the proviso. For clarity, the Committee sought to include the reference to ‘free reserves’ in the proviso to Sec 68(2)(c).*



Application of Section 56(2)(viiia)/56 (2) (x) in case of Buy Back (5/6)

- ❑ Is redemption of preference shares a 'purchase' and consequently, a buyback ?
 - Definition under S. 115QA - Buy-back means “***purchase*** by a company of its own share in accordance with the provisions of **any law for the time being in force relating to companies**” - Does not restrict to buy-back u/s 68 of Co's Act
 - Anarkali Sarabhai v. CIT [1997] 224 ITR 422 (SC) – redemption is sale by shareholder i.e., purchase by the Company



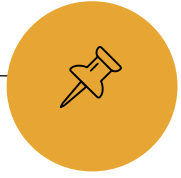
Application of Section 56(2)(viiia)/56 (2) (x) in case of Buy Back (6/6)

❑ GAAR implications :

- Commercial substance?
- Rule 10U – GAAR Grandfathering – transfer of investment made prior to April 1, 2017
- S. 115QA levies an additional income tax. The definition of the tax benefit under Rule 10U(3)(iv) refers to saving of 'tax'. 'Tax' is defined u/s 2(43) of the IT Act to mean income tax and does not include additional income tax.

❑ GAAR consequences

- Deem the buyback at fair value instead of nominal value?
 - ○ Section 98 - consequence of invoking GAAR is an inclusive definition but only empowers the tax officer to disregard or re-characterize the transaction or to reallocate the accrual of income among the parties. Section 98 does not empower the tax officer to deem the fair value as the accrual of income (fair value of shares as buy back price)
- 50CA in the hands of shareholders? – can recharacterize as a sale or transfer



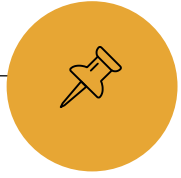
Application of Section 56(2)(x) – Family Transfer (1/3)

Referring to the legislative intent of introducing section 56(2) (vii) and section 56(2) (viii) of the Act, the Memorandum to the Finance Bill, 2010 explained that the provisions of section 56(2)(vii) of the Act were introduced as a counter evasion mechanism to prevent laundering of unaccounted income under the garb of gifts.

Thus, the intention to introduce section 56(2)(vii) was to cover only property which is transferred under garb of gifts and was introduced as an Anti-Abuse Measures, which as the nomenclature connotes, covers specific provision the practice of avoidance of tax by the assessee through artificial means. However, in case of a bona fide family arrangement, the main objective is to secure and maintain peace and harmony within the family members.

Various judicial precedents¹ in the context of Gift Tax Act, 1958 held that gift-tax under the said law should not be triggered in case of a bona fide family arrangement entered voluntarily between the family members. Therefore, section 56(2)(x) of the Act should not apply since the said section is a specific section to curb anti-avoidance tax practices and should not extend to genuine family arrangements.

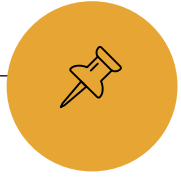
¹CIT v. Kay Arr Enterprises (Madras HC), CGT v. D. Nagarathinam (Madras HC), CWT v. Santokh Singh (Delhi HC), Ziauddin Ahmed v. CGT (Guwahati HC), Smt. A. Omera Parvez/ Smt. Shameena Banu/ Smt. Ameera Parvez/ Smt. A. Ameena Begum v. GTO (Chennai Tribunal)



Family Settlements a 'Transfer' ? (2/3)

The question has often arisen before the Courts as to whether such family settlements result in transfer ?

1. The Hon'ble Supreme Court in the case of **Ramcharandas V/s. Girjanandinidevi, AIR 1966 SC 323** held that “....Family settlement **between the members of the family** bonafide to put and end to the dispute amongst themselves is not a transfer;
2. It may not be out of place to mention here that judiciary* has held that transfer of properties, shares held by a **family managed limited company**, even if through a family arrangement, **is a transfer**.
3. Thus, transactions under 3 and 4, though under the aegis of Family settlement, would be subject to the provisions of transfer as per the Income-tax Act, 1961.



Family Settlements a 'Transfer' ? (3/3)

❑ Transfer by Company pursuant to family settlement –

- Manjula Finance Ltd v. ITO [2020] 12 TMI 731 (Del T) – No consideration – gift, no capital gain to company
 - Considers - B.A.Mohota Textiles Traders Pvt. Ltd. v. DCIT [2017] 82 taxmann.com 397 (Bombay HC)
 - S. 2(24)(iv) – for the recipient – argued but not decided, not being a issue for the doner (SKM Shree Shivkumar v. ACIT [2014] 48 taxmann.com 346 (Chen T))
- Recipient – ACIT v. Ms. Anitha Kumaran (ITA No.1164/Chny/2019) – 56(2)(vii)
 - Facts – Investment in properties out of family funds and the entire shareholding was with family members.
 - Distinguished – B.A.Mohota Textiles Traders Pvt. Ltd. (supra) – (i) only 80% shares with the family; (ii) arbitration award amongst a family; (iii) dispute in relation to capital gain



SECTION 50 CA – OVERVIEW (1/4)

- New provision in case of transfer of unquoted shares
- Analogous to s. 50C
- Where the consideration received or accruing
- On transfer of share of a company other than a quoted share.
- If such consideration < FMV (as per Rule 11UAA)
- Then, Such FMV will be considered as Full value of consideration for the purpose of Section 48.
- The section applies only if the shares are held as capital asset and not as stock-in-trade.
- The section applies to all shares whether equity or preference. However, the section does not cover convertible debentures.
- Effective from AY 2018-19.



Comparing S.50CA and S.56(2)(x) (2/4)

PARTICULARS	S.50CA in hands of transferor	S.56(2)(x) in hands of transferee
Seller is relative of purchaser (not for an adequate consideration)	Yes	No
There is gift to a relative	No	No
There is gift to a non relative	No	Yes
Transfer of shares of listed company	No	Yes
Difference between 11 UA value and actual consideration is < 50K	Yes	No



EXAMPLE – 1 (Inadequate Consideration) (3/4)

Mr. A transferred 10,000 shares to Mr. B

Cost of acquisition - $10,000 \times 10 = 1,00,000$

Consideration - $10,000 \times 30 = 3,00,000$

FMV - $10,000 \times 50 = 5,00,000$

PARTICULARS	In hands of Mr. A (TRANSFEROR)	In hands of Mr. B (TRANSFeree)
SECTION	50 CA	56 (2) (x)
COMPUTATION	FMV-COA	FMV-CONSIDERATION
GAINS	$= 5,00,000 - 1,00,000 = 4,00,000$	$= 5,00,000 - 3,00,000 = 2,00,000$
TAXABILITY	Income is chargeable to tax under head 'Capital Gains' amounting to Rs.4,00,000	Since FMV - Consideration > Rs.50,000, so the differential amount Rs2,00,000 shall be taxable u/s 56(2)(x)



EXAMPLE – 2 (Without Consideration) (4/4)

Mr. A transferred 10,000 shares to Mr. B

PARTICULARS	Scenario 1	Scenario 2
SECTION	56 (2) (x)	56 (2) (x)
	NO.OF SHARES =10,000 FMV = Rs.50	NO.OF SHARES =10,000 FMV = Rs.4
FMV	=10,000*50=5,00,000	=10,000*4=40,000
TAXABILITY	Since FMV > Rs.50,000, so the amount Rs5,00,000 shall be taxable u/s 56(2)(x)	Since FMV < Rs.50,000, so the amount Rs5,00,000 shall not be taxable u/s 56(2)(x)

Under section 50CA – It is taxable in both the cases.



Applicability of section in case of “Gift” by one company to another (1/2)

Gagan Infraenergy Ltd vs. DCIT (ITAT Delhi)

Date: 15th May 2018

Background:

Huge volume of shares in a company were transferred by assessee to another company without any consideration and without any proper documentation being executed as per law, giving it name of “Gift”.



Applicability of section in case of “Gift” by one company to another (2/2)

Judgement and conclusion:

After considering all the facts and circumstances of the case, it is held that the AO has correctly observed that gift by a corporation to another corporation is a strange transaction as there cannot be a gift between artificial entities/persons. The submissions filed by the Appellant are considered and not found to be tenable.

The assessee has to establish to the hilt, the factum, genuineness and validity of the transaction, the right to enter into such transaction especially when, revenue challenges its genuineness. There is no agreement/document that has been executed between group companies forming part of family realignment. To postulate that a company can give away its assets free to another even orally, can only be aiding dubious attempts at avoidance of tax payable under the Act unless it is supported by documentary evidence

It has been vehemently contested by authorities. CIT (DR) contented that transaction has been effectuated for avoiding payment of tax and to get out of the ambit of section 56 (2) (viiia) of the Act. Hence benefit of exemption under section 47 (iii) can not be granted.



Taxability of the credit to the general reserve by the amalgamated company (1/2)

Aamby Valley Ltd vs. ACIT (ITAT Delhi)

Date: 22nd February 2019.

Background:

Section 56(2) (viiia) is an anti-abuse provision which applies only to cases of bogus capital building and money laundering. It does not apply to an amalgamation where shares are allotted at alleged undervaluation.

Increase in general reserves due to recording of assets of amalgamating company at FMV not give rise to any real income to the assessee. It is capital in nature



Taxability of the credit to the general reserve by the amalgamated company (2/2)

Judgement and conclusion:

This is an important judgement by Tribunal which deals with the taxability of the credit to the general reserve by the amalgamated company of the fair valuation of the assets received under the scheme of amalgamation. The Tribunal held that the transaction does not give rise to real income to the assessee and it thus cannot be treated as a business profit.

Provisions of Section 56 (2) (viiia) will not be applicable if fair value of the shares received was not higher than the sacrifice suffered by taxpayer under the composition reorganisation scheme, as there is no incremental benefit to the shareholder.

Reserve directly credited to general reserve and not in P&L cannot be subjected to MAT.



Valuation of share can be done only on basis of FMV and Not Market Value

DCIT Mumbai vs Ozoneland Agro Pvt Ltd (ITAT Mumbai) - Date: 2nd May 2018

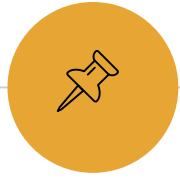
Background

A.O. observed that two persons transferred their shares to the assessee at Rs.75.49 per share whereas, on the same day all the other shareholders transferred their shareholdings to the assessee at Re.1 per share. He observed that when the market rate is Rs.75.49/share, the assessee has purchased the shares at less than the market price i.e., Re.1 per share and therefore, the transactions attract provisions of section 56(2) (viiia) of the I.T. Act.

The assessee however argued that under section 56(2)(viiia) FMV as calculated under Rule 11U is to be considered and not market price. And FMV of the shares were negative and hence the section has no applicability in the given case.

Judgement and Conclusion

The Tribunal on due consideration ruled that the action of AO was outside the ambit of law and only FMV under Rule 11U can be considered and not Market price. Hence dismissing appeal by the AO.



Valuation of Share to be done as per Rule 11UA (1/2)

Minda SM Technocast Pvt. Ltd vs. ACIT (ITAT Delhi)

Date: 7th March 2018

Background:

Section 56(2)(viia) read with Rule 11UA, The “Fair Market Value” of shares acquired has to be determined by using the values of the underlying assets and not their market values

In the present case, the assessee has acquired shares of TEPL at Rs.5 per shares. The assessee claimed to have valued the shares of TEPL as per the provisions of Rule 11UA of the Rules. AO was of the view that the assets are to be valued at the fair market value which will increase the value of shares to 45.72 and difference Rs. 40.72 being subjected to tax.



Valuation of Share to be done as per Rule 11UA (2/2)

Judgement and conclusion:

“Fair Market Value” of a property, other than an immovable property, means the value determined in accordance with the method as may be prescribed”

On the plain reading of Rule 11UA, it is revealed that while valuing the shares the book value of the assets and liabilities declared by the TEPL should be taken into consideration. There is no whisper under the provision of 11UA of the Rules to refer the Fair Market Value of the land as taken by the Assessing Officer as applicable to the year under consideration. Therefore, ITAT was of the view that the share price calculated by the assessee of TEPL for Rs. 5 per shares has been determined in accordance with the provision of Rule 11UA.



THANK YOU



Hiral Sejpal, Partner

Hiral started the international tax practice, valuation and due diligence in the firm. She is currently involved in family settlement, arbitration and restructuring. An alumni of Leiden International tax Centre, her research work at the world's leading Dutch tax research institution gives her an edge among the reputed international tax lawyers.



Mobile: 9833114028



E-mail: hiralsejpal@dcsejpalandco.com



Contact



Office 1:

Ministry of New, 3rd Floor, Kitab
Mahal, 192 DN Road, Azad Maidan,
Fort, Mumbai – 400001

Office 2:

2007-08, Cyber One, Sector 30A,
Vashi, Navi Mumbai – 400703



Website: www.dcsejpalandco.com