CBDT proposes changes to Rule 11UA in respect of ANGEL TAX - Also proposes to notify Excluded Entities

In the Finance Act, 2023, an amendment has been introduced to bring the consideration received from non-residents for the issue of shares under section 56(2)(viib) of the Income-tax Act, 1961(the Act). According to this provision, if the consideration for issuing shares exceeds their Fair Market Value (FMV), it will be taxable as 'Income from other sources'.

Rule 11UA for valuation of shares for the purposes of section 56(2)(viib) of the Act is proposed to be modified and notification of entities to which the said provision shall not apply is also being issued separately.

Proposed changes in Rule 11UA :

As a result of this amendment, Rule 11UA, which deals with the valuation of shares for section 56(2)(viib), is proposed to be modified.

A. Rule 11UA proposes to include 5 more valuation methods, available for non-resident investors, in addition to the existing Discounted Cash Flow (DCF) and Net Asset Value (NAV).

B. The proposed changes suggest that the FMV of equity shares corresponding to the consideration received from a notified non-resident entity may be taken as the FMV of the equity shares for resident and non-resident investors, provided that the consideration does not exceed the aggregate consideration received from the notified entity, and it is received within ninety days of issuing the shares.

   On similar lines, price matching for resident and non-resident investors would be available with reference to investment by Venture Capital Funds or Specified Funds.

C. It is proposed that the valuation report by the Merchant Banker for the purposes of this rule would be acceptable, if it is of a date not more than ninety days prior to the date of issue of shares which are subject matter of valuation.

D. Further, to account for forex fluctuations, bidding processes and variations in other economic indicators, etc. which may affect the valuation of the unquoted equity shares during multiple rounds of investment, it is proposed to provide a safe harbor of 10 % variation in value.

E. The draft Rules on the above lines will be shared for public comments for 10 days, after which these will be notified.

Notification for Excluded entities

Furthermore, a notification is proposed to exclude certain classes of non-resident investors from the applicability of section 56(2)(viib) of the Act. This includes:

I. Government & Government-related investors (such as central banks, sovereign wealth funds, international or multilateral organizations or agencies including entities controlled by the Government or where direct or indirect ownership of the Government is 75% or more.)

II. Banks or entities involved in Insurance business subject to applicable regulations,

III. Any of the following entities, which is a resident of a certain countries or specified territories having robust regulatory framework:-

   a) Entities registered with Securities and Exchange Board of India as Category-I Foreign Portfolio Investors,

   b) Endowment Funds associated with a university, hospitals or charities,

   c) Pension Funds created or established under the law of the foreign country or specified territory,

   d) Broad based pooled fund or investment vehicle where investor count is more than 50 and where such fund is not a hedge fund or a fund which employs diverse or complex trading strategies.

For Investment in Start-ups

Regarding investments in startups, the proposal aims to modify Notification No. S.O 1131(E) dated 5th March, 2019, stating that the provisions of section 56(2)(viib) will not apply to consideration received by startups covered under specific paragraphs of the notification issued by the Ministry of Commerce and Industry.