



Dadar East Study Circle

Section 56 and Rule 11UA

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Section 56(2)(x)

Section 56(2)(x): Provisions

- Section 56(2)(x)(a): Taxation of money exceeding Rs. 50,000 received without consideration
- Section 56(2)(x)(b): Taxation of immovable property received:
 - If received without consideration & stamp duty value > Rs.50,000, then stamp duty value will be considered as income
 - In case of inadequate consideration, stamp duty value - actual consideration will be considered as income, provided that,
 - The difference between stamp duty value and actual consideration is greater than, the higher of the following:
 - a) Rs. 50,000
 - b) the amount equal to 5% of the consideration (proposed amendment 10% by FB 2020)

Section 56(2)(x): Provisions

- Section 56(2)(x)(c): Taxation of any property other than the above:
 - If received without consideration & FMV > Rs.50,000, then FMV will be considered as income
 - If there is inadequate consideration whereby the difference between FMV & consideration exceeds Rs.50,000 then (FMV - Consideration) will be considered as income

Section 56(2)(x): Exceptions

- The provisions of section 56(2)(x) shall not apply to the following receipts:
 - from any relative
 - on the occasion of the marriage of the individual
 - under a will or by way of inheritance
 - in contemplation of death of the payer or donor, as the case may be
 - from any local authority as defined u/s 10(20)
 - from any fund/ foundation/ university/ other educational institution/ hospital/ other medical institution/trust or institution referred to in section 10(23C)
 - from or by any trust or institution registered u/ss 12A or 12AA

Section 56(2)(x): Exceptions

- The provisions of section 56(2)(x) shall not apply to the following receipts:
 - by any fund/ trust/ institution/university/ other educational institution/ hospital/ other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) section 10(23C)
 - from an individual by a trust created or established solely for the benefit of relative of the individual
 - pursuant to certain transactions not regarded as transfer u/s 47

Property

- As defined under the Explanation to section 56(2)(x) read with Explanation to section 56(2)(vii), 'property' means the following **capital asset** of the assessee:
 - Immovable property, being land or building or both
 - Shares & securities
 - Jewellery, Bullion
 - Archaeological collections, Drawings, Paintings, Sculptures, Work of art

Relative

Definition of relative is unchanged:

- In the case of an individual:
 - spouse of the individual
 - brother or sister of the individual
 - brother or sister of the spouse of the individual
 - brother or sister of either of the parents of the individual
 - any lineal ascendant or descendant of the individual
 - any lineal ascendant or descendant of the spouse of the individual
 - the spouse of any of the persons referred to in 2 to 6 above
- In the case of HUF: any member thereof
- Receipt by HUF from member: Covered in definition of relative" - Hence, exempt

Gift as defined in Gift Tax Act

➤ Gift as defined in GTA:

“transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration in **money or money's worth...**“

➤ Absence of money or money worth in section 56(2)(x) makes any difference ?

Section 56(2)(x)(a) – sum of money

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

- Limit of Rs 50,000 is qua donee – section 56 triggers when any person receives in any previous year from **any person or persons**Section 56(2)(x)(a) refers to **aggregate value** of such sum
 - Receipt by donee from Mr A, B, C in each less than Rs 50,000 but in aggregate greater than Rs 50,000 is covered
- Meaning of ‘sum of money’ – SC in H.H. Shri Rama Verma v. CIT [1991] (187 ITR 308)

“The context in which the expression 'sums paid by the assessee' has been used makes the legislative intent clear that it refers to the amount of money paid by the assessee as donation. . . . Therefore, . . . the donation must be a **sum of money** paid by the assessee. The plain meaning of the words used in the section does contemplate **donations in kind**. . . “

Section 56(2)(x)(a) – sum of money

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

- But it can be 'any' money. As per RBI

“There is no unique definition of ‘money’, either as a concept in economic theory or as measured in practice. Money is a means of payment and thus a lubricant that facilitates exchange. Money also acts as a store of value and a unit of account. In the real world, however, money provides monetary services along with tangible remuneration. It is for this reason that money has to have relationship with the activities that economic entities pursue. Money can, therefore, be defined for policy purposes as the **set of liquid financial assets**, the variation in the stock of which could impact on aggregate economic activity. As a statistical concept, money could include certain liquid liabilities of a particular set of financial intermediaries or other issuers.

*<https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=9455>

Section 56(2)(x)(a) – sum of money

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

- Status of following – whether can be said to be ‘any sum of money’.
 - Bank FD [See CIT v. Anuj Agarwal [2010]3Taxmann.com 46 (Mum.-ITAT)]
 - Receivable
 - Wallet money – Paytm, Google Pay etc
 - Foreign currency
- Money be received in cash or via bank transfer – may be received in India or abroad

Section 56(2)(x)(a) – sum of money

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

- Section 2(d) of Indian Contract Act defines 'consideration' as:
 - “When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise”
- Extent of recourse of definition of consideration in ICA to section 56(2)(x)?
- Consideration should be understood in context of business proper
 - Subvention
 - Subsidy

Section 56(2)(x)(a) – sum of money

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

- Charge of Section 56(2)(x)(a) in respect of 'sum of money' is only for sum of money received without consideration and not for sum of money received for inadequate consideration
- Therefore adequacy of consideration is not to be tested for receipt of 'sum of money' which otherwise would be relevant in the context of receipt of property
- Following would stand excluded from scope
 - Under-recovery of price
 - Obtaining goods at concessional rate
 - Subsidy in form of concessional interest rate

Section 56(2)(x)(b) – any immovable property

➤ Meaning of immovable property

"immovable property" shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth

[section 2(26) of the General Clauses Act, 1897]

" immovable property" does not include standing timber, growing crops or grass.

[section 3 of the Transfer of Property Act, 1882]

immovable property” includes land, buildings, hereditary allowances, rights to ways, lights, ferries, fisheries or any other benefit to arise out of land, and things attached to the earth, or permanently fastened to anything which is attached to the earth, but not standing timber, growing crops nor grass

[section 2(6) of the Registration Act, 1908]

Section 56(2)(x)(b) – any immovable property

56(2)(x) where any person receives . . .

(b) any immovable property . . . Without consideration or consideration less than stamp duty value

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

(l) from any relative . . .

"property" means the following capital asset of the assessee, namely:—

(i) **immovable property being land or building or both;**

Section 56(2)(x)(b) – any immovable property

- Other provisions in IT Act
 - S. 50C & S. 43CA - land or building or both
 - S. 54D, 54G, 54GA - land or building or any right in land or building
 - S. 269A & S. 269UA – immovable property inter alia means land or building or any right in land or building
- In context of section 50C which refers land or building, it is held that following assets are not included within the scope of provisions
 - Development rights - Voltas Ltd. v. ITO [2016] 74 taxmann.com 99 (Mumbai Trib.)
 - Lease rights 60 years - Atul G. Puranik v. ITO [2011] 141 TTJ 69 (Mumbai Trib.)
 - Right of Allotment / Right to Purchase – ITO v. Yasin Moosa Godil [2012] 52 SOT 344 (Ahmedabad Trib)

Section 56(2)(x)(b) – any immovable property

- Point of receipt of immovable property
 - Letter of Allotment
 - Registration
 - Possession
- First Proviso states where date of agreement fixing the amount of consideration for the transfer of immovable property and the date of registration are not same, stamp duty value on date of agreement may be taken
- It appears that 'receipt' as stated in section 56(2)(x) requires actual receipt of immovable property – act of letter of allotment, registration etc only grants right in immovable property and accordingly date of possession should trigger section 56(2)(x)

Section 56(2)(x)(b) – any immovable property

- FB 2020 provided tolerance limit of 10% on difference between stamp duty value and actual consideration
- Even though amendment is stated to be prospective reliance can be placed on following decisions to contend that amendment is retrospective
 - Chandra Prakash Jhunjunwala vs. DCIT [2020] 113 taxmann.com 246 (Kolkata - Trib.)
 - Kishore Hira Bhandari vs ITO [2019] 107 taxmann.com 218 (Mumbai - Trib.)
 - Amit Bansal vs ACIT [2018] 100 taxmann.com 334 (Delhi - Trib.)
 - Dharamshibhai Sonani vs. ACIT [2016] 75 taxmann.com 141 (Ahmedabad - Trib.)

Section 56(2)(x)(b) – any immovable property

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Section 56(2)(x)(b) – any immovable property

- Whether applicable to immovable property received as stock in trade ?
- In Trilok Chand Sain [2019] 174 ITD 729, the Jaipur Tribunal held that agricultural land falls under the definition of an immovable property & is hence covered under the ambit of section 56(2)(vii)(b) & it is immaterial whether the same is a capital asset or stock-in-trade
- Cost step up under section 49(4) as available on to capital asset and not as stock in trade
- Deduction can be claimed on amount taxed under section 56(2)(x) by placing reliance on SC in CIT v. Groz-Beckert Saboo Ltd [1979] 116 ITR 125 (SC) which held that market value of raw material received as gift was allowed as a deduction while computing business income.

Section 56(2)(x)(c) – Property

- Property should be capital asset of recipient/donee irrespective of the characterisation of property in hands of donor
- Stated conversely, receipt of property as stock in trade (other than immovable property) is not taxable under section 56(2)(x)
- Property is defined exhaustively and receipt of asset other than mentioned therein not covered within the purview of section 56(2)(x)
 - Undertaking – even if as part of undertaking assets listed in ‘Property’ are transferred as undertaking is a capital asset different from its constituents [CIT v Mugneeram Bangur [1965] 57 ITR 299 (SC)]
 - Watches, Ipads, Motor car
 - Intangible asset
 - Plant and machinery

Fresh issue of shares

- Section 56(2)(x) provides that "where any personreceives.....from any person or persons...property...for a consideration..."
- A plain reading of the section implies that it refers to a receipt of property by a company from any person or persons"
 - This implies that the shares should be property in the hands of the "donor" who should "give" these shares to the recipient. Thus, the "property" should be existing property; only then can it be received by the recipient from the giver
- Shares come into existence on allotment and till such allotment, the shares do not exist
- In Khoday Distilleries Limited, the Hon'ble Apex Court explained that there is a vital difference between "creation" and "transfer" of shares. The words "allotment of shares" has been used to indicate the creation of shares by appropriation out of the unappropriated share capital to a particular person

Fresh issue of shares

- The gift tax provisions have been introduced as an anti-abuse provision to target money laundering. Hence, in bonafide cases involving bonus issue, proportionate rights subscription or preferential allotment at fair commercial value or in compliance with other corporate law or exchange control regulations (which may incidentally be at value lesser than FMV as per section 56(2)), the taxpayer may also rely on legislative intent to support non-applicability of the provisions
- Possible to argue that the Second and Third Circulars (refer subsequent slides) are prejudicial to the taxpayers and hence not binding

CBDT Circulars in the context of section 56(2)(viiia)

➤ **Circular No. 10/2018 dated 31 December 2018 (First Circular)**

- Provisions of section 56(2)(viiia) shall not apply in case of receipts of shares by specified company / firm as a result of fresh issue of shares including by way of issue of bonus shares, right shares and preference shares or transactions of similar nature by specified company
- While expressing the above view, the First Circular considered the anti-abuse intent of the provision to prevent the practice of "transferring" shares of specified company without or for inadequate consideration

➤ **Circular No 2/2019 dated 4 January 2019 (Second Circular)**

- Matter relating to interpretation of the term 'receives' used in section 56(2)(viiia) is pending before the judicial forums and stakeholders have sought clarifications on similar current provision in section 56 of the Act
- First Circular is withdrawn and shall be considered to have been never issued
- Matter is required to be examined afresh so that a comprehensive circular on the matter can be issued

CBDT Circulars in the context of section 56(2)(viia)

- **Circular No.3/2019 dated 21 January 2019 (Third Circular)**
 - As mentioned in the Second Circular, a comprehensive review of the subject matter relating to interpretation of the term "receives" as used in, inter alia, section 56(2)(viia) of the Act and similar provisions contained in section 56(2) of the Act has been made by the Board in view of pendency of this issue in various judicial forums and clarifications sought by stakeholders
 - Keeping in view the plain reading as well as the legislative intent of section 56(2)(viia) and similar provisions contained in section 56(2) of the Act, being anti-abuse in nature, it has been decided that the view, as was taken in Circular No. 10/2018 [subsequently withdrawn by Circular No. 02/2019] that section 56(2)(viia) of the Act would not apply to fresh issuance of shares, would not be a correct approach, as it could be subject to abuse and would be contrary to the express provisions and the legislative intent of section 56(2)(viia) or similar provisions contained in section 56(2) of the Act
 - Therefore, any view expressed by the Board in Circular No. 10/2018 shall be considered to have never been expressed and accordingly, the said circular shall not be taken into account by any Income-tax authority in any proceedings under the Act

Bonus shares

- Bonus shares means new shares given free of cost to all the existing shareholders of the company, in proportion to their holding
- Any Additional Property?
 - In order to attract Section 56(2)(x) - Must be receipt of a property
 - In the case of bonus issue, no property is being conveyed to the shareholder in-as-much as the property therein is comprised in the existing shareholding of the allottee. There is as such no case of a gift; the shareholder only receiving his own property
 - Issue of bonus shares is just capitalisation of existing profits. The shareholder doesn't receive any additional property
 - For every bonus share issued, there is a corresponding reduction in the actual FMV of the equity share originally held

Bonus shares

- There is just a split of shares out of his existing holding. Its like exchanging a 100 rupee note for two 50 rupee notes
- No increase or decrease in the wealth of the shareholder as a result of the bonus issue. The percentage shareholding remains same
- Reference made be made to:
 - Sudhir Menon HUF v. ACIT [2014] 148 ITD 260 (Mum ITAT)
 - DCIT v. Dr. Rajan Pai [2016] 48 ITR(T) 170 (Bang ITAT) - Bonus shares can never be considered as received without consideration or for inadequate consideration calling for application of section 56(2)(vii)

Rights shares

- Rights issues are a proportionate number of shares available to all the existing shareholders of the company, which can be bought at a given price (usually at a discount to current market price) for a fixed period of time
- Proportionate allotment:
 - Shares are allotted pro-rata to the shareholders, based on their existing holdings
 - No additional property can be said to have been received by the shareholder Only an apportionment of the value of existing holding over a larger number of shares
 - No adverse tax implications as it is similar to issue of bonus shares
- Disproportionate allotment:
 - Provisions may get attracted as additional property could have been said to be received by the shareholder

Rights shares

- Reference may be made to:
 - **Sudhir Menon HUF (2014) 148 ITD 260 (Mum ITAT):** Where additional shares were allotted pro rata to shareholders based on their existing shareholding, there was no property being received on said allotment of shares & provisions of section 56(2)(vii)(c) did not apply to difference in book value & face value of additional shares
 - **Shri Subhodh Menon (2019)175 ITD 449(Mum ITAT):** section 56(2)(vii) is not applicable where the taxpayer has subscribed to rights shares pursuant to a bonafide business transaction
 - Benefit to relative - **Vaani Estates Pvt. Ltd [2018] 172 ITD 629 (Chen Trib.), Kumar Pappu Singh [2019] 174 ITD 465 (Visakh Trib.)**

Buy back of shares

- Trigger point for Section 56(2)(viiia)
 - receipt of property by an person;
 - from any person;
 - without or a lower consideration
- Must to receive a property in order to attract section 56(2)(x)
- Companies Act 2013 on buy back of shares
 - shares must be extinguished and physically destroyed within 7 days of the last date of completion of buy-back
- The Company does not, per se, receive its own shares on buy back. Infact, no property remains in existence, post buy back of shares
- Vora Financial Services P. Ltd. v. ACIT [[2018] 96 taxmann.com 88 (Mumbai)
- Position after section 115QA

Conversion of bonds/ preference shares into equity shares

- Receipt of equity shares is in consideration" of extinguishment of rights in bonds/ preference shares :-
 - Hence, not without consideration
 - Also not inadequate consideration - sacrifice = gain
 - Ratio of CIT Vs. Bai Shrinibai K. Kooka (46 ITR 86) (SC) and CIT vs. Groz-Beckert Saboo (116 ITR 125) (SC)
- Taxing event arises when convertible instrument is issued. Upon conversion :-
 - Mere working out of pre-existing rights of the investor or mere discharging of pre-existing obligation by the issuer
 - Ratio of CIT v Mohanbhai Pamabhai [1973] (165 ITR 166) and CIT v. R.M. Amin (106 ITR 368) (SC)

Conversion of company into LLP

- Exempt transfer u/s 47(xiii b); however not excluded u/s 56(2)(x)
- LLP receives all the existing rights, privileges, obligations of the company
- Property does not include undertaking
- Consideration is 'share in future profits or interest in the LLP'
- Whether same arguments applicable for non compliant conversion?

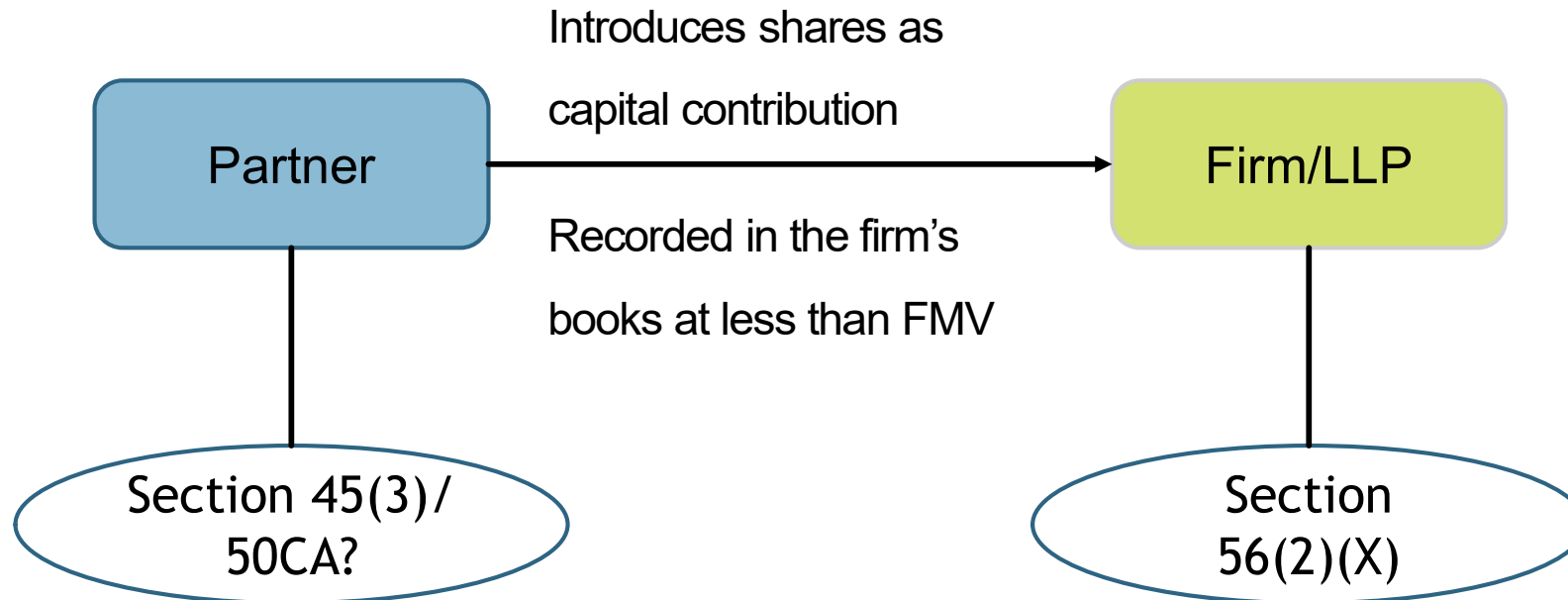
Interest in partnership/LLP

- Interest in partnership firm:
 - "securities" as defined u/s 2(h) of Securities contracts (Regulation) Act, 1956 includes "shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate"
 - Hence not covered
- Interest in LLP:
 - Meaning of "marketable security" - As per the SC decision in Bhagwati Developers Pvt Ltd Vs Peerless General Finance & Investment Company Ltd (Civil Appeal No 7445 Of 2004) - a marketable security is one which is freely transferable irrespective of the size of the market
 - Thus, interest in a LLP may not be covered (Section 42 of LLP Act, 2008 permits transfer. However, LLP Agreement may provide restrictions)

Relative

- Receipt by HUF from relative of Karta: not taxable [Harshadbhai Dahyalal Vaidhya (HUF)144 ITD 605(Ahd Trib)] taxable [Subodh Gupta (HUF)169 ITD 60 (Del Trib)]
- Receipt by member from HUF: Not explicitly covered by definition; However, relative includes group of relatives - HUF = Group of relatives. Hence not taxable
 - Vineetkumar Raghavjibhai Bhalodia v. ITO [2011] 46 SOT 97 (Rajkot), Shri Pankil Garg [TS-434-ITAT-2019(Chndg ITAT)]; contra view i.e. held as taxable in Gyanchand M. Bardia [2018] 93 taxmann.com 144 (Ahd ITAT)
- Receipt from nephew/ niece: Not covered under definition of relative - section 55(2)(x) shall apply
- Receipt by nephew/ niece: Covered under definition of relative - section 56(2)(x) shall not apply

Partner's capital contribution to Firm/ LLP



Amartara Pvt Ltd (I.T.A No. 6050/Mum/2016) (Mum ITAT)

Importing a deeming fiction provided in section 50C cannot be extended to another deeming fiction created by the statute in section 45(3) to deal with the special cases of transfer between partners & partnership firm & in such cases, section 45(3) provides for computation mechanism of capital gain and also provides for consideration to be adopted for the purpose of determination of full value of consideration

Partner's capital contribution to Firm/ LLP

- Consideration cannot be determined when partner contributes its asset in firm [Sunil Siddharthbhai v. CIT 156 ITR 509 (SC)]
- No provision akin to section 50D forming part of section 56(2)(x)
- The facts indicated that the entire transaction of contribution to partnership was a sham & fictitious transaction with an attempt to avoid tax. The provisions of section 45(3) will not apply in this case & for the purpose of determining the full value of consideration for the transfer, section 50C would apply given the fictitious nature of the transaction to avoid tax [Carlton Hotel (P) Ltd [2017] 399 ITR 611 (All HC)]

Interplay with section 68

- Section 68 as well as section 56(2)(viib), both are anti-abuse measures to prevent and generate unaccounted money.
- Trigger point:
 - Section 68 – cash credit in the books of accounts and source of such money is not identifiable
 - Section 56(2)(viib) – money received as share premium on account of issue of shares by the company
- When source of the share premium in the hands of a shareholder is not properly explained to the satisfaction of the AO – section 68
- If the transaction is genuine and the source is explained to the satisfaction of the AO – section 56(2)(viib)

Interplay with section 68

Sunrise Academy of Medical Specialities (India) P. Ltd. [2018] 257 Taxman 373 (Ker HC)

Ruling -

- Section 56(2)(viib) Is triggered at the stage of computation of income itself when the share application money received is above the face value & it cannot be controlled by provisions of section 68
- By virtue of proviso to section 68 the entire amount credited in the books of account for allotment of shares or application money, including the FMV would be taxable only in case of no explanation or unsatisfactory explanation
- If a satisfactory explanation is offered, “then the charge to tax will only be to that person exceeding the FMV; which anyways has to occur u/s 56(2)(viib)

Section 56(2)(viib)

Provisions

- Section 56(2)(viib) was inserted by the Finance Act, 2012 w.e.f. 1 April 2013
- The Finance Minister in the Budget Speech 2012 explained the object of introduction of section 56(2)(viib) as follows: “.....to deter the generation and use of black money, I propose to... increase the onus of proof on closely held companies for funds received from shareholders as well as taxing share premium in excess of fair market value”
- Anti-abuse provision to arrest circulation of unaccounted money by taxing the aggregate receipt on shares of a CHC issued for a consideration which is more than the FMV of shares
- Applicable to a CHC, if shares received from a resident
- FMV to be higher of the following:
 - Value determined in accordance with method prescribed under Rule 11UA(2), or
 - Value which the assessee substantiates to the satisfaction of the AO based on value of assets (including goodwill & other intangibles) on the date of issue of shares

Provisions

- Where consideration received > FMV of shares, Taxable Amount = Consideration - FMV
- Exclusions:
 - Issue of shares by a widely held company (WHC)
 - Issue of shares to NR
 - Issue by Venture Capital Undertaking to Venture Capital Company/ Venture Capital Fund
Notified companies - Notification 45/2016 dt 14.6.2016 exempts start-ups meeting DIPP requirement
 - Issue of securities other than shares - CCDs, warrants etc.

Amendments by the Finance (No 2) Act, 2019

- Presently exemption is available to venture capital undertakings receiving funds from a Category I AIF registered under the sub-category Venture Capital Fund
 - From AY 2020-21, the exemption has been extended to funds received from all sub-categories of Category-I AIFs as well as Category II AIFs

- In respect of a company which is exempted from section 56(2)(viib) rigors & subsequently fails to fulfil the conditions notified, not only the 'consideration received exceeding FMV of shares' shall be deemed to be income chargeable to tax for the previous year in which such failure has taken place, but it shall also be deemed that the company has misreported income attracting penalty u/s 270A @ 200% of the excess premium
 - Effective from AY 2020-21

Points for consideration

- No taxation if shares are subscribed at face value or issued to NR even if price is more than FMV [Edulink (P.) Ltd v ITO [2019] 108 taxmann.com 221 (Bangalore - Trib.)]
- Point of taxation
 - Receipt of share application money or allotment of shares
 - Section needs to be applied in year of allotment [Cimex Land and Housing (P.) Ltd v ITO [2019] 104 taxmann.com 240 (Delhi - Trib.)]
- Assessee has option to value shares either as per Rule 11UA or DCF method
Cinestaan Entertainment (P.) Ltd v ITO [2019] 106 taxmann.com 300 (Delhi - Trib.)

Valuation Rules

Rule 11U - Definitions

- "valuation date" means the date on which the property or consideration, as the case may be, is received by the assessee
- "balance-sheet" means:
 - For section 56(2)(viib) purpose - the audited balance sheet as drawn up on the valuation date or the immediately preceding balance sheet that has been adopted by the shareholders
 - Any other case - the audited balance sheet as drawn up on the valuation date

Application of Rule 11UA

- It is a trite law that rules are directory in nature
 - If a rule is valid, it has to be followed in each and every case
 - It is not a matter of choice or option, given in the hands of the tax payers or tax administrators. They are bound to follow the prescribed rules and cannot devise their own ways and means for valuing the assets
- Reference may be made to:
 - Bharat Hari Singhania vs CWT (1994) 73 TAXMAN 3 (SC)
 - Medplus Health Services P. Ltd. vs ITO (2016) (158 ITD 105) (Hyd Trib)

Balance Sheet for the purpose of section 56(2)(x)

- Balance Sheet for the purpose of valuation:
 - For section 56(2)(viib) purpose - the audited balance sheet as drawn up on the valuation date or the immediately preceding balance sheet that has been adopted by the shareholders
 - Any other case - the audited balance sheet as drawn up on the valuation date
- **No flexibility for Section 56(2)(x)**
 - Shares are mandatorily to be valued on the basis of audited balance sheet, as on the valuation date
 - Option to carry out valuation basis preceding year's audited balance sheet not provided

Practical difficulties

- FMV determination as per prescribed valuation method, could pose practical difficulty :-
 - To obtain an audited balance sheet drawn up as on the valuation date
 - For small value transactions, minor shareholders
 - In the case of multiple holdings or cross holdings
 - Valuing investments held by the entity

Jewellery, archaeological collections, drawings, paintings, sculptures, work of art – Rule 11UA(1)(a) & (b)

- FMV= estimated price which such item would fetch if sold in the open market on the valuation date
- FMV= the invoice value
 - If purchased on valuation date
 - Purchase is from registered dealer
- FMV= price it would fetch if sold in the open market on the valuation date
 - If received by any other mode
 - Value exceeds Rs. 50,000
 - Obtain report of registered valuer in respect of the price

Quoted shares & securities - Rule 11UA(1)(c)(a)

Mode of receipt	FMV
Received by way of transaction carried out through any recognized stock exchange	Transaction value as recorded in such stock exchange
Received by way of transaction carried out other than through any recognized Stock exchange	The lowest price of such shares and securities quoted on any recognized stock exchange on the valuation date and The lowest price as on the valuation date or on a date immediately preceding the valuation date, if such shares or securities are not traded on the valuation date

Unquoted equity shares - Rule 11UA(1)(a)(c)(b)

- $FMV = (A+B+C+D - L) \times PV/PE$
- A= book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance-sheet.
- 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= FMV 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

Unquoted equity shares - Rule 11UA(1)(a)(c)(b)

- L= book value of liabilities shown in the balance sheet LESS
 - paid-up capital in respect of equity shares
 - the amount set apart for payment of dividends on preference shares and equity shares_
 - reserves and surplus...
 - any amount representing provision for taxation...
 - any amount representing provisions made for meeting liabilities, other than ascertained liabilities
 - any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares
- PV= the paid up value of such equity shares
- PE = total amount of paid up equity share capital as shown in the balance-sheet

Unquoted shares other than equity shares which are not listed in any recognized stock exchange – Rule 11UA(1)(a)(c)(c)

- FMV= price it would fetch if sold in the open market on the valuation date
and
- the assessee may obtain a report from a merchant banker or an accountant in respect of which such valuation

CA and give Rule 11UA certificate for the purpose of section 56(2)(x) or section 50CA

Unquoted equity shares for the purpose of section 56(2)(viib) - Rule 11UA(2)

- 2 Options provided

- Option 1:

$$\text{FMV} = (A - L) \times \text{PV/PE}$$

A = Book value of all assets in Balance Sheet as reduced by any amount of tax paid/ deducted less refund claimed, if any and any amount shown as asset including unamortized amount of deferred expenditure which does not represent the value of any asset)

L = book value of liabilities shown in the balance sheet Less same items as stated under Rule 11UA(1)(c)(b)

- Option 2:

FMV = amount determined by a merchant bankers as per the Discounted Free Cash Flow method

** Words “or an accountant” omitted by the Income-tax (Sixth Amendment) Rules, 2018, w.e.f. 24 May 2018*

Unlike valuation for section 56(2)(x), section 50CA – no substitution of book value with prescribed duty for immovable property, jewellery, shares etc

Points for consideration

- Book value of asset is considered for Rule 11UA
 - Includes Revaluation of asset
 - Asset recorded in accordance with Ind AS which may include Financial Assets
- Liabilities may not include 'Other Equity' recorded in accordance with Ind AS
- No valuation prescribed for Bullion – whether charge fails?
- Valuation of shares involving cross holding
- Cases where there is no assessable stamp duty value for land and building

Thank You

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