

Date: 5<sup>th</sup> June, 2023

To,  
Shri Nitin Gupta  
Chairman,  
Central Board of Direct Taxes,  
North Block,  
Delhi – 110 001

Respected Sir,

**Sub: Representation – Draft Rule 11UA for implementing amendment made by the Finance Act, 2023 and notification on applicability of Section 56(2)(viib)**

The Chamber of Tax Consultants, established in 1926, is one of the oldest non-profit organizations of tax practitioners, having Advocates, Chartered Accountants and Tax Practitioners as its members spread across Pan India. Many senior tax professionals who regularly appear before ITAT, High Courts and the Supreme Court are its Past Presidents. It has from time to time made various representations to different Government Authorities drawing their attention to pressing issues.

The Finance Act, 2023 expanded the applicability of section 56(2)(viib) of the Income Tax Act, 1961 to the consideration received from non-resident investors for the issue of shares at more than Fair Market Value (FMV).

The press release by the Ministry of Finance dated 19<sup>th</sup> May 2023, notification dated 24<sup>th</sup> May 2023 and Circular dated 26<sup>th</sup> May 2023 (draft rules for public comments), provides for certain relaxations and exemptions in respect of issues of shares to non-residents and residents u/s 56(2)(viib) of the Income Tax Act, 1961 and Rule 11UA of the Income Tax Rules, 1962.

We hereby humbly draw your attention to few suggestions in respect of the amendments proposed by the said press release and the draft rules:

## 1. Additional methods of valuation

- **Proposed Amendment:** At present, Rule 11UA of the Income Tax Rules, 1962, prescribes two valuation methods with respect to valuation of shares viz. Discounted Cash Flow (DCF) and Net Asset Value (NAV) method for resident investors. It is proposed to include 5 more valuation methods namely Comparable Company Multiple Method, Probability Weighted Expected Return Method, Option Pricing Method, Milestone Analysis Method and Replacement Cost Method, available for non-resident investors, in addition to the DCF and NAV methods of valuation.
- **Suggestion:** The said additional methods shall also be available for resident investors.
- **Rationale:** We understand that the above amendment shall address the valuation issues in respect of entities wherein DCF or NAV value may not be appropriate methods of valuation. However, these challenges or issues are pervasive and applies even to a resident investors and in order to bring parity, the said option of additional valuation method should also be made available to resident investors. In other words, resident investors, investing in the growth of a company and thereby contributing to the growth of the nation, either investing independently or along with non-resident investors, should not be put on a weaker pedestal vis-à-vis a non-resident investor. Otherwise, a start-up would start preferring/giving priority to non-resident investors over resident investors.

## 2. Cap (quantum & time period) based on the investment by Notified class of investors and/or funds:



**The Chamber of  
Tax Consultants**  
Mumbai | Delhi

President  
Parag Ved

Hon. Jt. Secretaries  
Vijay Bhatt | Mehul Sheth

Vice President  
Haresh Kenia

Hon. Treasurer  
Neha Gada

Imm. Past President  
Ketan Vajani

- **Proposed Amendment:**

As per the proposed Rule 11UA(2)(c) and Rule 11UA(2)(e), the Price for issue of shares to the notified class of investors, Venture Capital Funds or Specified Funds may be taken as FMV of the equity shares for other investors (other than the notified investors) subject to two conditions –

- i. Investment from such specified class of investors is more than investment by remaining set of investors
- ii. Consideration is received within 90 days of the date of issue of shares

- **Concern for 1<sup>st</sup> Condition:**

The 1<sup>st</sup> condition, in effect requires the specified class of investors to subscribe to more than 50% of the fund raise, which in a later series round of a start-up may be a very high commitment. For example, if a unicorn startup is doing a fund of \$ 500 M (~Rs. 4,000 crores), it may have a varied class of investors including the specified class of investor, say they are contributing \$ 100 M (~Rs. 800 crores).

In that scenario, even as a substantial funding is done by specified investors (Rs. 800 crores), the start up would not be entitled to the proposed exemption for the fund raising round.

- **Suggestion for 1<sup>st</sup> Condition:**

A quantum threshold of minimum investment by the specified class of investor may be provided as an alternate to the 50% investment requirement. For example –



**The Chamber of  
Tax Consultants**  
Mumbai | Delhi

President  
Parag Ved

Hon. Jt. Secretaries  
Vijay Bhatt | Mehul Sheth

Vice President  
Haresh Kenia

Hon. Treasurer  
Neha Gada

Imm. Past President  
Ketan Vajani

*The contribution/participation by the specified class of investors is at least 50% of the funding round or Rs. 50 crores whichever is lower.*

- **Rationale of why Rs. 50 crores?**

Any of the specified class of investor (Government entity, Fund, etc.) before investing Rs. 50 crores would do detailed due diligence of the entity/start-up and equally take comfort of the proposed valuation and therefore, the risk of any bogus issue of shares (the objective behind Section 56(2)(viib)) can be said to be mitigated.

- **Concern for 2<sup>nd</sup> Condition:**

The proposed amendment provides for receipt of the consideration from such specified class of investors within a period of 90 days from the date of issue of shares. Practically, issuer companies match the drawdown schedule with the fund flow requirements of the business. In cases where there are partly paid shares and balance calls are to be made based on the actual fund requirement of the company, the benefit of the proposed amendment will not be available if the balance calls and resultant receipt of money is made post the aforesaid period of 90 days. This will impact the benefit of the proposed amendment in genuine business cases.

- **Suggestion for 2<sup>nd</sup> Condition:**

Instead of receipt of 100% consideration, an alternate threshold for receipt of minimum consideration can be provided. For example, it may be provided that at least 25% of the consideration shall be received within a period of 90 days and balance within a period of 18 or 24 months.



**The Chamber of  
Tax Consultants**  
Mumbai | Delhi

President  
Parag Ved

Hon. Jt. Secretaries  
Vijay Bhatt | Mehul Sheth

Vice President  
Haresh Kenia

Hon Treasurer    Imm. Past President  
Neha Gada        Ketan Vajani

- **Rationale of why 25%?**

This is in line with the deferred payment structure provided under FEMA laws (for FDI) and under SEBI Laws (for share warrants) and can be considered as reasonable threshold for ensuring genuineness of the transaction.

### **3. The valuation report can be from a registered valuer under Companies Act or Merchant Banker**

- **Proposed Amendment:**

Clause (d) (and also Clause (b)) of the proposed Rule 11UA(2) requires the valuation report is to be obtained from a merchant banker.

- **Suggestion:**

Registered valuer under Companies Act, 2013 should also be permitted to issue a valuation report for Rule 11UA.

- **Rationale:**

For issuance of shares, except for rights issue, a company is required to obtain a valuation report from a registered valuer under the Companies Act, 2013, which is generally used for FEMA purposes. However, as the Income Tax Act (Section 56(2)(viib) r.w.r 11UA(2)) requires a report from the merchant banker, even unlisted companies, in addition to a registered valuers report has to obtain a report from the merchant banker. Report from two different agencies (merchant banker and registered valuer), for the same transaction does not add much value i.e. the cost of obtaining two valuation reports, does not result in any peculiar benefit.

The concept of obtaining valuation report from a registered valuer under the Companies Act was not prevalent, when Rule 11UA(2) was originally introduced. The requirement under the Companies Act of obtaining a report from the registered valuer has been subsequently introduced.

#### 4. Notified entities covers – Banks or only Banks involved in insurance business

- **Proposed Amendment:**

The notified investors as per the Notification dated 24 May 2023 *inter alia* covers following (Language in the gazette has been reproduced below along with language in Hindi)

*“Banks or Entities involved in Insurance Business where such entity is subject to applicable regulations in the country where it is established or incorporated or is a resident;”*

ii) बीमा कारबार में लगे हुए बैंक या अस्तित्व जहां ऐसा अस्तित्व देश में लागू विनियमों के अधीन है जहां वह स्थापित या निगमित या निवासी है ;।

At the first blush reading the English text, one would feel that that banks and regulated insurance entities are entitled to the exemption. However, on reading the Hindi text only banks engaged in Insurance business would be covered and not all the banks. This (Hindi text) does not seem to the intention of the department to distinguish between banks engaged in insurance business and other banks. But now, if one re-reads the English text, even a possible interpretation (may not be the most appropriate interpretation – primarily due to lac of use of comma, reference to such entity and then no real need of referring to bank separately) is that, even banks (or entities) involved in insurance business

are covered and therefore, a bank not involved in insurance business would not be covered.

We are given to understand that banks in India cannot carry on Insurance business, it has to be carried on by a separate entity. Therefore, even for this reason one feels that, the department wants to grant exemption to banks and regulated insurance entities.

- **Suggestion:**

The Hindi text should be amended to clarify that, the exemption is for banks (irrespective of whether they carry on insurance business or not) and for regulated entities engaged in Insurance business.

This clarification will help in removing unintended ambiguity and disparity between the Banks having an insurance business and banks not engaged in insurance business.

Yours Sincerely,

For **THE CHAMBER OF TAX CONSULTANTS**

Sd/

Sd/-

Sd/-

**Parag Ved  
President**

**Ketan Vajani  
Co-Chairman  
Law and Representation Committee**

**Abhitan Mehta  
Chairman  
Direct Taxes Committee**