

REVAMPING OF ANGEL TAX AND VALUATION NORMS

CBDT has proposed review of the valuation rules ('Rule 11UA'), addressing Angel Tax complexities. The amendments aim to streamline compliance, enhance transparency, and provide clear valuation guidelines for startup shares. They also establish a framework for taxing consideration from non-residents when the investments are not in accordance with valuation norms. Changes are intended to foster an efficient & equitable taxation system while promoting the growth of the startup ecosystem.

Proposed Changes in Valuation Rules:

The amendments seek to enhance the valuation methods on issue of shares, establish guidelines for non-resident investors, and provide a relief through safe harbour provisions. The key aspects of the proposed changes include:

- ▶ **Expansion of Valuation Methods:** Rule 11UA currently prescribes the Discounted Cash Flow (DCF) and Net Asset Value (NAV) methods for valuing shares issued to resident investors. The proposed amendments aim to broaden the scope by including five additional valuation methods specifically tailored for non-resident investors over and above DCF and NAV. This expansion allows for greater flexibility and accommodates the specific requirements of diverse investment scenarios.
- ▶ **Deeming Provision:** Fair Market Value Calculation for Non-Resident Investors: Pursuant to the proposed amendments, a company receiving consideration for share issuance from a non-resident entity designated by the Central Government, the price of equity shares corresponding to such consideration may be deemed as Fair Market Value (FMV) of equity shares in hands of resident and non-resident investors. However, this valuation method is subject to the condition that the consideration from FMV does not exceed the aggregate consideration received from the specified non-resident entity and must be received within 90 days from issue date.
- ▶ **Alignment with Venture Capital & Specified Funds:** In line with ensuring fairness and parity, the proposed amendments extend the price matching provision to encompass investments made by Venture Capital Funds or Specified Funds.
- ▶ **Valuation Report** to be furnished by the Merchant Banker will be deemed acceptable if it is dated 90 days prior to the issue date.
- ▶ **Safe Harbour Provision:** Recognizing the potential impact of forex fluctuations, bidding processes, and economic indicators on the

valuation of unquoted equity shares during multiple investment rounds, a safe harbour provision has been introduced. This provision allows for a reasonable 10% variation in value, providing a margin to account for external influences.

Public Consultation and Excluded Entities:

The final rules will be notified after considering public comments for ten days and afterwards the same will be notified. Additionally, CBDT proposes to exclude certain classes of persons being non-resident investors to whom clause (viib) of subsection (2) of section 56 of the Act shall not be applicable). These entities are.

- ▶ Government and Government-related Investors such as Central banks, sovereign wealth funds, international or multilateral organizations or agencies controlled by the government with stake of 75% or more.
- ▶ 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.
- ▶ Resident Entities in Certain Countries or Specified Territories:
 - Entities registered with the Securities and Exchange Board of India as Category-I Foreign Portfolio Investors.
 - Endowment Funds associated with universities, hospitals, or charities.

- Pension Funds created or established under the law of the foreign country or specified territory.
- Broad Based Pooled Investment Vehicles or Funds where the number of investors exceeds 50 and such funds do not function as hedge funds or employ complex trading strategies.

▶ Consideration received from any person by startups covered under notification dated February 19, 2019 issued by the Ministry of Commerce and Industry through Department for Promotion of Industry and Internal Trade (DPIIT). Eligible startups covered those are

- Recognised by DPIIT under para 2(iii)(a) or as per any earlier notification on the subject, and;
- Aggregate paid up share capital (proposed or issued) plus premium upto Rs 25 Crore, and;
- Must have filed Form 2 to DPIIT

Issues Alive for Consideration:

Proposed amendments to Rule 11UA provides no relaxation to the following, hence the same remain alive for consideration:

- Foreign Direct Investment (FDI) involving investments in subsidiaries by overseas parent companies.
- Startup's already having share capital including premium more than Rs 25 Crore.

Consequently, both these categories are obligated to adhere with existing regulations and requirements governing FDI transactions.

Conclusion

The proposed amendments to Rule 11UA and the notification of excluded entities reflect the CBDT's commitment to refine the valuation process and provide greater clarity in the context of Angel Tax. These changes aim to ensure fairness and promote consistency in the treatment of both resident and non-resident investors. By incorporating public feedback and acknowledging the specific circumstances of excluded entities, the CBDT endeavours to create a more transparent and supportive environment for startups and investors alike.

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