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NEWSLETTER

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MVDCO ADVISORY SERVICES

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INCOME TAX

Sale/Transfer of Unquoted Shares – Get your valuation right!

When an owner of Unquoted share ("Shares") in a Company transfers the shares to any person, he is required to pay Capital Gain tax on the difference between the sale consideration received by him and the cost of acquisition of such shares (or the inflation indexed cost, wherever applicable).

It is important to check if the "Sale consideration" that he receives from the buyer is at least equal to or more than the "Fair Market Value" ("FMV")as defined under Rule 11UA of The Income Tax Rules, of the shares sought to be transferred.

As defined under Rule 11UA, the fair market value of **unquoted equity shares** shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner under (a) or (b), at the option of the assessee, namely; -

INCOME TAX*(cont.)*

Option (a):

The fair market value of unquoted equity shares shall be calculated simply by ascertaining "Book value of Assets (Less) Book value of Liabilities."

- For ascertaining the book value of assets, following amounts shall be excluded:
  - Advance Tax, Tax deduction or collection at source or any amount of tax paid as reduced by refund claimed under the Income Tax Act.
  - Any unamortized amount of deferred expenditure which does not represent the value of any asset.
- For ascertaining the book value of liabilities, following amounts shall be excluded:
  - the paid-up capital in respect of equity shares;
  - the amount set apart for payment of dividends on preference or equity shares
  - reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
  - any amount representing provision for taxation, other than amount of tax paid as reduced by the amount of tax claimed as refund
  - 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.

Option (b):

The fair market value of the unquoted equity shares as determined by a Merchant Banker as per Discounted Free Cash Flow Method. Earlier, a Chartered Accountant was also permitted to determine the FMV of such equity shares. However, with effect from 24th May 2018, this right of Chartered Accountant is taken away and therefore only Merchant Banker is authorised to determine the FMV of such equity shares.

If the transaction of transfer of shares takes place at a price **which is less than the FMV**, there is a tax impact both on buyer of the shares as well as the seller. The legislation has made an attempt to In order to ensure the full consideration is not understated in case of transfer of unlisted shares, section 50CA.

Impact of Tax on Seller – Section 50CA:

If the seller receives sale consideration on sale/transfer of unquoted equity shares which is less than the FMV of such shares, the FMV of such shares shall be deemed to be the Sale consideration received or accrued on such transfer of shares. Therefore, while computing the Capital Gain on transfer of shares, FMV of share will replace the actual sale consideration on transfer of such shares. The seller, in such case, will have to pay Capital Gain tax on difference between FMV of the shares and cost price (or the inflation indexed cost price, as the case may be) of such shares.

Impact of Tax on Buyer – Section 56(2)(x):

If the buyer acquires unquoted equity shares from a seller which is less than the FMV of such shares, the difference between the FMV of the shares and actual price paid by the buyer (in so much as it exceeds Rs. 50,000/-) will be taxable in the hands of the buyer under the hear “Income from Other Sources.”

It is important to note here that both these sections are applicable only when the seller or the buyer, in respective cases, holds the shares as **Capital Asset ie. As Investment**. This is not applicable when the shares are held as Stock in Trade.

INCOME TAX *(cont.)*

Any such shares received (by the buyer) under the following circumstances would be ***outside the ambit*** *of section 56(2)(x) -*

(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; or*

(v) *from any local authority; or*

(vi) *from any trust or institution referred to* in section 10(23C); or

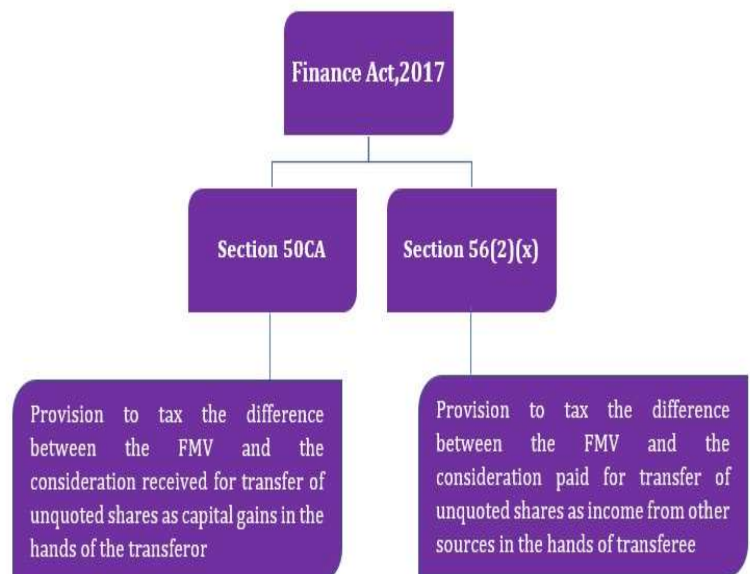
(vii) from any trust or institution registered under section 12AA; or

(viii) by way of transaction not regarded as transfer under specific circumstances as stated under Section 47; or

(ix) from an individual by a trust created solely for the benefit of relative of the individual.

Section 49(4) – diluting impact on buyer:

In the event when under section 56(2)(x), the buyer is charged to tax on the difference between the FMP of the shares and the actual price paid by the buyer, Section 49(4) comes to the rescue of such buyers. According to this section, whenever this buyer sells these shares, the cost of acquisition will be taken to be value which has been considered for the purpose of Section 56(2)(x). Thus, the buyer will be saved from double taxation on the differential amount.



Interplay between section 50CA & section 56(2)(x)

Example 1: -

Buyer: - A Seller: - B

A purchased 100 shares of unquoted company from B @ Rs.600/- per share. Thus, total consideration is Rs. 60,000/-. B had acquired these shares @ Rs. 500/- per share i.e. Total cost of Rs. 50,000/-. Current FMV is say Rs. 700/ Share.

Impact of S.50CA on B	
FMV of shares	70,000
Less: Cost of Acquisition	(50,000)
Capital Gains	20,000

Impact of S.56(2)(x) on A	
FMV of shares	70,000
Less: Actual money received	(60,000)
Income from other Source	10,000

Impact u/s 49(4): -

When A subsequently sell shares at (say) Rs.800/- (which is also the FMV):

FMV of shares (when sold)	**80,000**
Less: - FMV of shares (when purchased)	(70,000)
Capital Gains	**10,000**

Thus, although the actual purchase price for A was only Rs. 60,000/- (but he had paid tax on FMV of Rs. 70,000/-), he will be able to claim Rs. 70,000/- as cost of shares whenever he sells these shares.

INTERNATIONAL TAX

How to claim Foreign Tax Credit?

With increased scale of globalisation and growing levels of economic activities, the entrepreneurs, to explore global market potentials, are expanding their business activities in various countries. This has led to increased cross border transactions which in turn raises many issues on double taxation of their income.

Every Company/Individual is taxed on its global income in the country of its residence. A Company/Individual is also exposed to tax in the country where it has its Source of income.

Therefore, they are exposed to double taxation on the same income, if source of such income is derived from another country. This is hindrance to smooth flow of cross border transactions. Many countries have therefore signed Double Tax Avoidance Agreements (DTAA) as a solution to address this problem of double taxation.

The basic aim of the DTAAs is to allocate taxation right between the country of residence and country of source. Generally, the country of resident allows credit of the taxes paid in country of source.

India has framed rules (Rule 128) that regulates and defines the manner in which such foreign tax credit shall be available to such residents while they claim credit for the taxes paid in country of source of their income.

Based on the rules and regulations made, following is an attempt to clarify a few questions that arises on getting credit of the Foreign Tax paid.

- **What is Foreign Tax Credit (FTC)?**

  - ✓ FTC is tax paid in foreign country on income derived in foreign country by an assessee. It can also be tax deducted at source in the foreign country by a non-resident on the source of income generated by a resident in foreign country. Such amount of tax which is paid/deducted in foreign company can be claimed as credit against the tax liability in the country of resident.

- **In which year the credit is available?**

  - ✓ The credit of FTC is available in the year in which the income corresponding to such tax has been offered to tax in India.
  - ✓ In case the income corresponding to such tax is offered to tax in India in multiple years, the FTC shall be claimed across those years in the same proportion in which the income is offered to tax.

- **Against which liability credit can be claimed?**

  - ✓ The FTC can be claimed against amount of Income Tax, surcharge and cess liability. It, however, cannot be claimed against any liability on account of interest, fee or penalty payable under the Income Tax Act.
  - ✓ If foreign tax is disputed in any manner, the same cannot be claimed against tax liability in India. However, once the dispute is settled, the credit for such tax can be claimed in the year in which income is offered for tax in India on furnishing of evidence of settlement of dispute, proof of payment of such disputed tax and requisite undertaking.

- **What is the mechanism to compute the amount of FTC available?**

  - ✓ The FTC shall be computed for each source of income arising from each country.
  - ✓ The credit allowable shall be lower of tax payable under the Income Tax Act on such income and actual foreign tax paid on such income.
  - ✓ In case where the foreign tax paid exceeds the amount of tax payable according to the Double Tax Avoidance Agreement, such excess shall be ignored.

- **What documents are required to claim FTC?**

  - ✓ A Statement of computation of Income of that country outside India and foreign tax deducted or paid on such income in Form No. 67;
  - ✓ A certificate or statement specifying the Nature of Income and the manner of tax deducted therefrom or paid by the assessee from –
    - a) The tax authority of that country or
    - b) The person responsible for deduction of such tax or
    - c) The assessee. In such case, the assessee also need to provide
      - ➢ Acknowledgement of online payment of tax or bank counter foil or challan for payment of tax where the payment has been made by the assessee:
      - ➢ Proof of deduction of tax where the tax has been deducted.

- **Whether the FTC can be claimed if tax is payable under Minimum Alternative Tax (MAT)?**

  - ✓ Yes, FTC shall be allowed against tax payable under MAT in the same manner as it is allowable under normal provisions of the Income Tax Act.
  - ✓ However, where the FTC available against tax payable under MAT exceeds the tax credit available under normal provisions of the Act, the excess shall be ignored.

INTERNATIONAL TAX*(cont.)*

- **What is the timeline to submit the claim of FTC?**

  ✓ The statement in Form No. 67 and a certificate or statement as referred above shall be furnished on or before the due date specified for furnishing return of income under section 139(1) of The Income Tax Act. This form needs to be filed online.

- **What conversion rate should be adopted?**

  ✓ For the purpose of converting foreign currency into Indian rupee, Telegraphic Transfer Buying Rate on the last day of the previous month in which the tax has been paid or deducted shall be adopted.

  ✓ Telegraphic Transfer Buying rate is the rate adopted by the State Bank of India for buying such currency.