

# Changes in Rule 11UA w.r.t to computation of FMV for issuance of shares by closely held companies

## Rule 11UA - provides for method of calculation of fair market value (FMV)

Section 56(2)(viib) imposes income tax on closely held companies on consideration for issuance of shares where the issue price exceeds the face value and the FMV of the shares. In order to establish the principles for determining FMV of the shares, Rule 11UA of the Income Tax Rules was introduced. Earlier, for the purpose of arriving at the FMV of **shares** for the purpose of the section 56(2)(viib), Rule 11UA provided for only two methods of valuation, that is, NAV method and DCF method.

As introduced in [section 32 of Finance Act, 2023](#), pursuant to inclusion of non-resident investors within the scope of section 56(2)(viib), the valuation methodologies prescribed in Rule 11UA(2) has been amended vide [Income-tax \(Twenty first Amendment\), Rules, 2023](#). Now, (i) additional 5 methods have been prescribed that can be adopted by the merchant banker appointed for the valuation purpose in case of valuation of shares issued to non-resident; (ii) valuation methods for Compulsorily convertible debentures ('CCPS') has also been prescribed. This is based on public consultation on the draft rules. ([PIB notification](#)).

### Key Highlights

1	Changes <b>effective from</b> - September 25, 2023 from the date of issue
2	Introduction of methods of <b>valuation of FMV for CCPS</b>
3	<b>Validity of the valuation:</b> - Equity shares and CCPS can be issued by a company on the basis of valuation report which is issued by merchant banker not earlier than 90 days from date of issue of equity shares/CCPS.
4	<b>Safe harbour</b> - <ul style="list-style-type: none"> <li>- Shares can be issued at a price variation not exceeding 10% of value where valuation has been done either by NAV method or DCF by a merchant banker where the shares are issued to a <u>resident</u>.</li> <li>- Shares can be issued at a price variation not exceeding 10% of value where valuation has been done either by NAV method or by a merchant banker following any of the remaining 6 methods mentioned in Table 1 where the shares are issued to a <u>non resident</u>.</li> </ul>
5	<b>Price matching / benchmarking:</b> In case of shares issued to AIFs / VC fund / VC companies / <a href="#">notified entities</a> , price at which the unquoted equity shares have been issued to these entities can be taken as FMV, subject to the following conditions: <ul style="list-style-type: none"> <li>- the consideration should have been received within the range of 90 days before / after the date of issue of equity shares in question; and</li> <li>- the total consideration received from the equity shares in question should not exceed the total consideration received from such entities. This point is also clarified by way of an illustration.</li> </ul>
6.	<b>Valuation of CCPS:</b> The FMV of CCPS can be calculated in either the following manner <ul style="list-style-type: none"> <li>- Where issued to <u>resident</u>: <ul style="list-style-type: none"> <li>- Valuation of CCPS in question using either DCF or Price Matching Method; or</li> <li>- Valuation of the equity shares of the issuer using NAV, DCF or Price Matching</li> </ul> </li> <li>- Where issued to <u>non resident</u>: <ul style="list-style-type: none"> <li>- Valuation of CCPS in question using any method except NAV</li> <li>- Valuation of the equity shares of the issuer using any method</li> </ul> </li> </ul>

### Applicable rules for valuation of FMV

Unquoted securities issued:	Applicable law
Equity shares	Section 56(2)(viib) and (x) read with rule 11UA(2)(A) and 11UA(1)(c)
Redeemable Preference Shares ('RPS')	Section 56(2)(viib) and (x) read with rule 11UA(1)(c)
Convertible Preference Shares ('CCPS')	Section 56(2)(viib) read with rule 11UA(2)(B)
Optionally Convertible Preference Shares ('OCPS')	Section 56(2)(viib) and (x) read with rule 11UA(1)(c)
Warrants	Section 56(2)(x) read with rule 11UA(1)(c)
Redeemable Debentures	Section 56(2)(x) read with rule 11UA(1)(c)
Compulsorily Convertible Debentures ('CCD')	Section 56(2)(x) read with rule 11UA(1)(c)
Optionally Convertible Debentures ('OCD')	Section 56(2)(x) read with rule 11UA(1)(c)

**Table: 1 Methods of valuation of shares (Equity + CCPS) for unlisted companies**

	Erstwhile sub-rule (2)	Amended sub-rule (2)	
		Resident	Non-resident
<b>Formula driven</b>			
<b>Net Asset Value (NAV) Method</b> It should be noted that under sub-rule (2), NAV (at book value) is to be computed unlike Adjusted NAV (considering market value of jewellery, shares, immovable property) required under sub-rule (1). Sub-rule (1) is referred to for computation of FMV under section 56(2)(x).	✓	✓	✓
<b>To be computed by merchant banker</b>			
<b>Discounted Cash Flow (DCF) Method</b> This method determines valuation of shares by discounting the estimated cash flow.	✓	✓	✓
<b>Comparable Company Multiple (CCM) Method</b> Based on key financial indicators of other similar companies, like PE multiples etc.	X	X	✓
<b>Probability Weighted Expected Return Method (PWERM) -</b> It determines value of shares based on probability-weighted present value of various future outcomes.	X	X	✓
<b>Option Pricing Method -</b> for warrants / OCPS / OCD. There are two parts - (a) for the cash flows from the securities, DCF method may be applied, (b) for the option - option pricing models like Binomial Distribution or Black Scholes Model or Monte Carlo simulation may be carried out	X	X	✓
<b>Milestone Analysis Method -</b> milestone based achievement. Focusing on critical company milestones, this method links valuation to key achievements such as product launches or market expansions.	X	X	✓
<b>Replacement Cost Method -</b> What will be the cost for similar earning capacity establishing today - this is only for traditional business - different for different scenarios	X	X	✓
<b>Price matching / Benchmarking Method</b>			
- in case shares have been issued to AIFs / VCs etc during past / coming 90 days	X	✓	✓
- in case shares have been issued to entities notified under clause (ii) of first proviso of section 56(2)(viib)	X	✓	✓