



CBDT notifies rules for computation of fair market value and reporting requirements in relation to indirect transfer provisions

Section 9(1)(i) of the Income-tax Act, 1961 (the Act) provides that if any share or interest in a foreign company or entity derives its value substantially from the assets located in India, then such share or interest is deemed to be situated in India. Thereby, any income arising from the transfer of such share or interest is deemed to accrue or arise in India.

The share or interest is said to derive its value substantially from assets located in India if the fair market value (FMV) of assets located in India comprise at least 50 per cent of the FMV of total assets of the company or entity. Further, Section 285A of the Act mandates reporting requirement on the Indian concern through or in which the foreign company or entity holds the assets in India. Rules with respect to computation of FMV of Indian and global assets were required to be prescribed. Further, the information to be furnished and manner of furnishing the same were also required to be prescribed.

On 23 May 2016, the Central Board of Direct Taxes (CBDT) had issued draft rules¹ to prescribe the manner of computation of FMV of assets of the foreign company or entity and the reporting requirements by the Indian concern through the amendments of the Income-tax Rules, 1962. Draft forms for reporting requirements have also been prescribed. The CBDT had invited comments and suggestions from stakeholders and the general public on the draft rules and forms.

Now, the CBDT² has notified the rules and forms. The rules are summarised as follows:

I. Computation of FMV of assets (tangible or intangible) as on the specified date, held directly or indirectly by a foreign company or entity

Particulars	Computation of fair market value	Remarks
Listed Share of an Indian company i. listed on the recognised stock exchange;	Observable price ³ of such share on the stock exchange	Where the share is listed on more than one recognised stock exchange, the observable price shall be computed with reference to the

¹ F No. 142/26/2015-TPL, dated 23 May 2016

² CBDT Notification 55/2016, dated 28 June 2016

³ 'Observable price' in respect of a share quoted on a stock exchange shall be the higher of the following:-

(a) the average of the weekly high and low of the closing prices of the shares quoted on the said stock exchange during the six months period preceding the specified date; or

(b) the average of the weekly high and low of the closing price of the shares quoted on the said stock exchange during the two weeks preceding the specified date;

ii. If such share(s) confers any 'right of management or control' ⁴ in relation to Indian company:	<p>Fair market value = (A+B)/C</p> <p>A= the market capitalisation of the company on the basis of observable price of its shares quoted on the recognised stock exchange</p> <p>B= the book value of liabilities of the company as on the specified date</p> <p>C= the total number of outstanding shares</p>	recognised stock exchange which records the highest volume of trading in the share during the period which is considered for determining the price
Share of an Indian company not listed on a recognised stock exchange	As determined by a merchant banker or an accountant in accordance with any internationally accepted valuation methodology for valuation of shares on arm's length basis as increased by the liability, if any, considered in such determination	
Interest in partnership firm or an association of person (AOP)	<p>Value on the specified date of such firm or AOP, as determined by a merchant banker or an accountant in accordance with any internationally accepted valuation methodology as increased by the liability, if any, considered in such determination</p> <p>The portion of the value computed above shall be allocated among its partners or members in the proportion in which capital has been contributed by them. The residue of the value shall be allocated among the partners or members in accordance with the agreement of partnership firm or association of persons for distribution of assets in the event of dissolution of the firm or association, or, in the absence of any such agreement, in the proportion in which the partners or members are entitled to share profits. The sum total of the amount so allocated to a partner or member shall be treated as the fair market value of the interest of that partner or member in the firm or the association of persons, as the case may be.</p>	
Other	Price it would fetch if sold in the open market on the specified date as determined by a merchant banker or an accountant as increased by the liability, if any, considered in such determination.	

Computation of FMV of all the assets of a foreign company or the entity

Particulars	Computation of fair market value	Remarks
Where the transfer of share of, or interest in, the foreign company or entity is between the persons who are not connected persons ⁵	<p>Fair market value of all assets = A+B</p> <p>A = Market capitalisation of the foreign company or entity computed on the basis of the full value of consideration for transfer of the share or interest;</p> <p>B = Book value of the liabilities of the company or the entity as on the specified date as certified by a merchant banker or an accountant;</p>	

⁴ 'Right of management or control' shall include the right to appoint majority of the directors or to control the management or policy decision exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of shareholding or management rights or shareholders agreements or voting agreements or in any other manner

⁵ 'Connected person' shall have the meaning as assigned to it in Section 102 of the Act

<p>Case other than above</p> <ul style="list-style-type: none"> Shares listed on a stock exchange 	<p>Fair market value of all assets = A+B</p> <p>A= Market capitalisation of the foreign company or entity computed on the basis of the observable price of the share on the stock exchange where the share of the foreign company or the entity is listed</p> <p>B= Book value of the liabilities of the company or the entity as on the specified date</p>	<p>If the share is listed on more than one stock exchange, the observable price shall be in respect of the stock exchange which records the highest volume of trading in the share during the period considered for determining the price</p>
<ul style="list-style-type: none"> Unlisted shares 	<p>Fair market value of all assets = A+B</p> <p>A= Fair market value of the foreign company or the entity and its subsidiaries on a consolidated basis as determined by a merchant banker or an accountant as per the most appropriate internationally accepted valuation methodology</p> <p>B= Value of liabilities of the company or the entity, if any, considered for the determination of FMV in A.</p>	

Determination of Income attributable to assets in India

Particulars	Computation of fair market value	Remarks
<p>Income from transfer outside India of a share of, or interest in, a company or entity</p>	<p>A* B/C</p> <p>A= Income from the transfer of the share of, or interest in, the company or the entity computed in accordance with provisions of the Act as if such share or interest is located in India</p> <p>B= FMV of assets located in India as on specified date, from which the share or interest referred to in A derives its value substantially</p> <p>C= FMV of all the assets of the company or entity as on specified date</p>	<p>If the transferor of the share of, or interest in, the company or the entity fails to provide the information required for the application of the formula then the income from the transfer of such share or interest attributable to the assets located in India shall be determined in such manner as the Assessing Officer may deem suitable.</p>

- The transferor of the share of, or interest in, a company or entity that derives its value substantially from assets located in India, shall obtain and furnish along with the return of income a report in Form 3CT. It should be duly signed and verified by an accountant providing the basis of the apportionment in accordance with the formula and certifying that the income attributable to assets located in India has been correctly computed.

Additional points

- Where fair market value has been determined on the basis of any interim balance sheet then the fair market value shall be appropriately modified after finalisation of the relevant financial statement in accordance with the applicable laws and all the provisions of this Rule and Rules 11UC and 114DB shall apply accordingly.
- For determining the fair market value of any asset located in India, being a share of an Indian company or interest in a partnership firm or association of persons, all the assets and business operations of the said company or partnership firm or association of persons shall be taken into account irrespective of whether the assets or business operations are located in India or outside.
- The rate of exchange for the calculation in foreign currency, of the value of assets located in India and expressed in rupees shall be the telegraphic transfer buying rate of such currency as on the specified date.

II. Documentation requirements under section 285A

- Every Indian concern referred to in Section 285A of the Act is required to maintain and furnish the information and documents as prescribed in these rules.
- The information is to be furnished in Form 49D electronically under digital signature to the jurisdictional officer of Indian concern. The same is to be furnished within a period of ninety days from the end of the financial year in which any transfer of the share of, or interest in, a company or entity has taken place
- The Indian concern is obligated to maintain numerous documents and also produce the same when called upon in the course of any proceeding. Such information and documents are required to be maintained for a period of eight years.
- Where there are more than one Indian concerns that are constituent entities of a group, the information may be furnished by any one Indian concern, if, (i) the group has designated such Indian concern to furnish information on behalf of all other Indian concerns that are constituent of the group, and (ii) the information regarding the designated Indian concern has been conveyed in writing on behalf of the group to the Assessing officer. These conditions shall have no effect if the designated Indian concern fails to furnish the information in accordance with the provisions of this rule.
- The rules also define the terms 'ultimate holding company or entity', 'intermediate holding company or entity' and 'immediate holding company or the entity' with respect maintaining of documentation.

Our comments

Taxation of capital gains arising on account of indirect transfer has been a matter of litigation before the courts. The retrospective amendment and manner of bringing such capital gains tax have raised more debate and it has invited attention of foreign investors. In this regard, relevant provisions were introduced by the Finance Act, 2012 with retrospective effect from 1 April 1962. Subsequently these provisions were amended by Finance Act, 2015. Section 9(1)(i) of the Act provides that FMV of assets on the specified date shall be determined in such a manner as may be prescribed. CBDT has now notified rules with respect to computation of fair market value and reporting requirements in relation to indirect transfer provisions.

The rules provide the mechanism to compute the fair market value in different scenarios. It is imperative to note that if the transferor of shares fails to provide the information which is necessary for the application of the formula then the income from the transfer of such share or interest attributable to the assets located in India shall be determined in such manner as the AO may deem suitable.

Draft rules provided computation of FMV of assets being interest in limited liability partnership. The same has been removed in the final rules.

The final rules provide that in a case where there are more than one Indian concerns that are constituent entities of a group, the information may be furnished by any one designated Indian concern. However, if such entity fails to provide the details it may impact the every group companies.

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