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TAX FLASH NEWS

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CBDT issues draft rules for computation of fair market value and reporting requirement in relation to indirect transfer provisions

According to the provisions of Section 9(1)(i)[1] of the Income-tax Act, 1961 (the Act), 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 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 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.

Now, the Central Board of Direct Taxes[2] (CBDT) has prescribed 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. Forms for reporting requirements have also been prescribed. The CBDT has invited comments and suggestions of stakeholders and general public on the draft rules and forms by 29 May 2016. The draft rules are summarised as follows:

I. Computation of FMV of assets (tangible or intangible) as on the specified date[3], held directly or indirectly by a foreign company or entity

Particulars	Computation mechanism	Additional mechanics
Listed Share of an Indian company i. listed on recognised stock exchange;	Observable price[4] of such share on the stock exchange	Where the share is listed on more than one recognised stock exchange, the observable price shall

[1] Read with Explanation 5 to Section 9(1)(i) of the Act
[2] F No. 142/26/2015-TPL, dated 23 May 2016
[3] 'Specified date' means the –
- Date on which the accounting period of the company or, as the case may be, the entity ends preceding the date of transfer of a share or an interest; or
- Date of transfer, if the book value of the assets of the company or, as the case may be, the entity on the date of transfer exceeds the book value of the assets as on the date referred to in above bullet, by fifteen per cent.

[4] 'Observable price' in respect of a share quoted on a stock exchange is the higher of the following:
- the average of the weekly high and low of the closing prices of the shares quoted on the said exchange during the six months period preceding the specified date; or
- the average of the weekly high and low of the closing price of the shares quoted on the said exchange during the two weeks preceding the specified date.

ii. If such share(s) confers any right of management or control in relation to Indian company:	**Fair market value = (A+B)/C** A= the market capitalisation of the company on the basis of observable price of its shares quoted on the recognised stock exchange B= the book value of liabilities[5] of the company as on the specified date C= the total number of outstanding shares	be computed with reference to the 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 pricing methodology for valuation of shares on arm's length basis and increased by the liability, if any, considered in such determination	
Interest in partnership firm or in a limited liability partnership (LLP) or an association of person (AOP)	Proportional enterprise value on the specified date of such firm or LLP 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	
Others	Price it would fetch if sold in the open market on the specified date as determined by a report from a merchant banker or an accountant as increased by the liability, if any.	

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

Particulars	**Computation mechanism**	**Additional mechanics**
If transfer of share or interest is between persons who are not associated persons and the consideration for transfer of share or interest is determined on the basis of a report prepared by an accountant or merchant banker of international repute	Value determined in such report as increased by the aggregate amount of liabilities that have been reduced for computing the value of assets for determination of such consideration	
Cases other than above • Shares listed on a stock exchange	**Fair market value of all assets = A+B** 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 B= Book value of the liabilities of the company or the entity as on the specified date	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 which is

[5] 'Book value of the liabilities' means the value of liabilities as shown in the balance-sheet of the company or the entity as the case may be, excluding the paid-up capital in respect of equity shares/members' interest.

		considered for determining the price
• Unlisted shares	**Fair market value of all assets = A+B** 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 B= Book value of liabilities of the company or the entity as on the specified date.	

Determination of Income attributable to assets in India

Particulars	**Computation mechanism**	**Non-compliance**
Income from transfer outside India of a share of, or interest in, a company or entity	**Fair market value = A* B/C** 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 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 C= FMV of all the assets of the company or entity as on specified date	If the transferor of the share of, or interest in, the company or entity fails to provide the information which is necessary for the application of the aforesaid formula then whole of the income from the transfer of such share or interest shall be deemed to be attributable to the assets located in India.

- 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.

Rate of exchange

- 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[6] 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 or interest has taken place

  Stricter timeline is proposed (thirty days from the transaction) where the transaction is in respect of the share or the interest which effects, directly or indirectly, transfer of the right of management or control in relation to the Indian concern.

[6] 'Telegraphic transfer buying rate' means the rate or rates of exchange adopted by the State Bank of India for buying such currency, having regard to the guidelines specified from time to time by the Reserve Bank of India for buying such currency, where such currency is made available to that bank through a telegraphic transfer (Explanation to Rule 26 of the Rules)

- 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.
- 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 always been a matter of litigation and debate. The retrospective amendment and manner of bringing such capital gains tax did raise more issues and was sought to be settled in an investor-friendly way. In this regard, it was proposed to provide detailed rules for computation of FMV of assets held directly or indirectly by foreign entity. These rules were eagerly awaited. The CBDT now prescribes the rules with a window period of about a week for stakeholder and general public to provide their comments/suggestions (to be provided by 29 May 2016).

The draft rules provide the mechanism to compute the fair market value in different scenarios. It has also burdened the Indian concern with the onerous requirement of maintaining detailed documents that to for the period of eight years.

It is imperative to note that if the transferor of shares fails to provide the information which is necessary for the application of the computational mechanism then whole of the income from the transfer of such share or interest would deemed to be attributable to the assets located in India and thereby attracting Indian tax on full capital gains arising on such transaction.

There may be a situation where it may not be possible for the Indian concern to collect/maintain/provide the details prescribed. This could be genuinely a case of impossibility of performance for Indian concern. Rules in present form do not address such situation and one will have to deal with penalty provisions under Section 271GA of the Act.

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