Law on Taxability of Gifts: A Comprehensive Analysis

By **Shri. Narayan Jain** & **Shri. Deepak Jain**, Advocates

1. Hitherto provisions relating to gifts:

Up to September, 1998 any amount received without consideration was taxable as gift under Gift Tax Act. From October, 1998 to August, 2004 any amount received as gift or without consideration no tax was leviable either for giver or receiver.

Thereafter, in Section 56(2), a Clause (v) was inserted vide Finance (No.2) Act, 2004 to provide that a sum of money exceeding Rs.25,000 received by an individual or HUF from any person after 01.09.2004 without consideration will be deemed to be income. In this provision amount was chargeable only if a single receipt was more than Rs.25,000. Hence, gifts became legalized as before this it was always debatable and issue before A.O. was that whether particular amount is gift or unexplained credit by the assessee in the form of gift. Such sums of money received as gifts, other than those in circumstances covered in exceptions in section 56(2), are to be treated as income from other sources. Such sum will not be treated as income from other sources if such receipt falls in those exceptions.

Amount received from any relative, as defined in explanation to section 56(2)(v)/(vi) is also not chargeable to tax.

Above provision was further amended by introduction of a new clause (vi) in Section 56(2) w.e.f. 1.4.2006 to provide that if **aggregate amount received during the year is more** than Rs. 50,000 the same will be chargeable to tax. Other conditions remained the same as were provided in Clause (v).

In short, the provisions relating to tax on such receipts have travelled as under:

Period	Taxability
Up to 30/09/1998	Liable for tax as gift under the Gift Tax Act in the hands of the donor if amount of gift exceeded Rs.30,000 in a year
01/10/1998 to 31/08/2004	No tax on such sum
01/09/2004 to 31/03/2006	Taxable u/s 56(2)(v) as income but only *sum of money* if the same exceeds Rs.25000 from each person
01/04/2006 to 30/09/2009	Taxable u/s 56(2)(vi) as income but only *sum of money* if same exceeded in aggregate Rs.50000 in a year in the hands of the recipient from all donors
01/10/2009 onward	Taxable Receipt of sum of Money, Immovable property as well as certain specified movable property if the amount exceeds Rs.50000 in aggregate in case of each of such category of assets
01/6/2010 onwards	**sec. 56(2)(viia) inserted to tax Partnership Firms and unlisted companies (i.e. companies in which public are not substantially interested) when shares of specified companies are received without consideration or at inadequate consideration**

2. Provisions of section 56(2)(vii) applicable only if the recipient of sum of money or specified property is an Individual or HUF:

The provisions of section 56(2)(vii) inserted w.e.f. 1.10.2009 are applicable only if the recipient of sum of money or specified property is an Individual or HUF.
However section 56(2)(viia) has been introduced to cover partnership firms and certain companies if they receive specified shares.

3. **Provisions not applicable in case the specified properties are received from a relative or in other prescribed circumstances:**

The provisions of section 56(2)(vii) inserted w.e.f. 1.10.2009 are not applicable in case the specified properties are received from a relative or in other prescribed circumstances.
In the following circumstances the prescribed amounts or the value of the property received are not chargeable to tax u/s 56(2)(vii)-

(a) Any receipt of sum of money or any property from any relative;
(b) Receipt on occasion of the marriage;
(c) Receipt under a Will;
(d) Receipt by way of inheritance;
(e) Receipt in contemplation of death;
(f) Receipt from a local authority as defined in the Explanation to section10(20);
(g) Receipt from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in section10 (23C);
(h) Receipt from any trust or institution registered u/s 12AA.

4. Meaning of relative:

The provisions of section 56(2)(vii) inserted w.e.f. 1.10.2009 are not applicable in case the specified properties are received from a relative or in other prescribed circumstances.
The term "relative" as defined includes spouse, brother, sister, brother or sister of spouse, brother or sister of either of the parents, any lineal ascendant or descendant of the individual or of the spouse and spouse of any of the persons mentioned above. Following is the list of some persons considered relative of an individual for the purpose of section 56(2)(vii)-

Relatives from whom Gift is permissible

List of Male Donors	***List of Female Donors***
Father (Papa or Pitaji)	Mother (Maa or Mummy)
Brother (Bhai)	Sister (Bahin)
Son (Beta or Putra)	Daughter (Beti or Putri)
Grand Son (Pota or Potra)	Grand Daughter (Poti or Potri)
Husband (Pati)	Wife (Patni)
Sister's Husband (Jija)	Brother's Wife (Bhabhi)
Wife's Brother (Sala)	Wife's Sister (Sali)
Husband's Brother (Dewar)	Husband's Sister (Nanad)
Mother's Brother (Mama)	Mother's Sister (Mausi)
Mother's Sister Husband (Mausa)	Wife's brother's wife (Sala Heli)
Father's Brother (Chaha or Tau)	Father's Brother's Wife (Chachi or Tai)

Father's Sister's Husband(Fufa)	Father's Sister (Bua)
Grand Father (Dada)	Grand Mother (Dadi)
Great Grand Father (Pardada)	Great Grand Mother (Pardadi)
Daughter's Husband (Jawai)	Son's Wife (Bahu or Putra Vadhu)
Wife's Father (Sasur)	Wife's Mother (Sas)
Husband's Father (Sasur)	Husband's Mother (Sas)
Wife's Grand Father (Dada Sasur)	Husband's Grand Mother (DadiSas)
Husband's Grand Father (Dada Sasur)	Wife's Grand Mother (Dadi Sas)
Wife's Great Grand Father (Bada Dada Sasur)	Husband's Great Grand Mother (Badi Dadi Sas)
Husband's Great Grand Father (Bada Dada Sasur)	Wife's Great Grand Mother (Badi Dadi Sas)
Brother's Wife (Bhabhi)	Mother's Brother's Wife (Mami)
	Husband's Brother's Wife (Devrani or Jithani)

If an individual gets any gift from the above relatives, it may be claimed exempt, being outside the purview of section 56(2)(vii). Interestingly if a Bhagna or Bhanja receives a gift from his Mama (Maternal Uncle) it is exempt being covered in the definition of relative but if an Individual receives a gift from his Bhagna or Bhanja (Sister's son) it is not exempt being not covered in the definition of relative for the purpose of section 56(2)(vii). That means the Income Tax Act does not recognise bilateral relations so far it appears from this example of Mama Bhanja. Similar situation will arise in case of Chacha- Bhatija. If Bhatija (Nephew) gets a gift from Uncle, it will be exempt but if an Individual (Chacha or Uncle) gets gift from his nephew or niece, it will not be exempt and will be taxed. We feel the relationship is mutual and therefore the CBDT needs to revisit the definition of relative for the above purpose.
Similar definition of "relative" was also applicable u/s 56(2)(v) and 56(2)(vi).

5. Specified properties covered u/s 56(2)(vii):

The provisions of section 56(2)(vii) are applicable w.e.f. 1.10.2009 on the receipt **sum of money** and specified properties, as mentioned hereunder.

For this purpose *"property"* ***means the following capital assets –***

(i) immovable property being land or building or both
(ii) shares and securities
(iii) jewellery
(vi) archaeological collections
(vii) drawings
(viii) paintings
(ix) sculptures or
(x) any work of art.
(xi) Bullion [w.e.f. 1.6.2010]

These are summarised below -

(a) **Sum of money:**

Where any **sum of money** exceeding Rs. 50,000 in aggregate in any previous year is received by an individual or HUF without any consideration the aggregate sum shall be deemed to be the income of the recipient.

(b) **Immovable property transferred without consideration:**

Where immovable property is received by an individual or HUF without any consideration and the value of such property for stamp duty purpose exceeds Rs.50,000, the value of the said property for the stamp duty purpose would be taxable as income from other sources.

(c) **Immovable property transferred at a consideration which is lower than the valuation of the property for stamp duty purpose:**

Immovable Property at consideration, now outside the scope of section 56(2)(vii): When the strenuous provisions regarding taxing of gifts of immovable property were introduced last year in 1.10.2009, it had application on :

(i) immovable property received at inadequate consideration by individuals and HUFs; and
(ii) immovable property received without any consideration.

In this Budget, the Hon'ble FM has **retrospectively amended the provision w.e.f. 1.10.2009 to provide that section 56(2)(vii) will only apply to immovable property received without consideration**. There was immense confusion among people after the enactment of the provisions last year, and many of them got their property registered within the cut off date i.e. 30.09.2009. This retrospective amendment will provide considerable relief to the buyers of immovable property at a consideration.

(d) **Transfer of specified properties other than immovable properties without consideration:**

Where a property, specified for this purpose, other than immovable property, is received by an individual or HUF without any consideration and the fair value of the same exceeds Rs.50,000 then the fair market value of the property shall be deemed to be the income of the recipient.

(e) **Transfer of specified properties other than immovable properties for a consideration lower than fair market value:**

Where a property specified for this purpose, other than immovable property is received by an individual or HUF for a consideration and such consideration is less than the fair market value of the property by an amount exceeding Rs.50,000, the fair market value reduced by the consideration paid, would be taxable as income from other sources.
For the purpose of computing capital gains on subsequent transfer of such property by the recipient, cost of acquisition u/s 49 shall be increased by the amount of value taxed as above under the head 'income from other sources'.

6. Post amendment Taxability u/s 56(2)(vii) at a glance :

Nature of Assets	***Particulars***	***Value Taxable***
Sum of Money	Without consideration	Whole amount if same exceeds Rs.50,000
Immovable property	Without consideration	Whole amount of the stamp duty value of the property, if it exceeds Rs.50,000
Any specified property, other than immovable property	Without consideration	the aggregate fair market value of which exceeds Rs.50,000, the whole of the aggregate fair market value of such property
Any specified property, other than immovable property	With consideration	consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs.50,000, the aggregate fair market value of such property as exceeds such consideration

From the above table it is clear that in various categories, if the amount of sum of money or the fair market value of the property received without consideration or if the difference in consideration shown and fair market value/ stamp duty is within Rs.50,000 then it will not be included in income. But if the amount of gift exceeds Rs.50,000 the whole amount of gift becomes taxable.

7. What is meant by "In Contemplation of Death" :

Under clause (d) of the second proviso to section 56(2)(*vii*), any sum of money or other specified movable property received 'in contemplation of the death of the payer' is granted exemption from tax. It is, therefore, necessary to understand the exact import of what is meant by 'in contemplation of death'.

The requirements of a 'gift in contemplation of death' are laid down in section 191 of the Indian Succession Act, 1925. This section reads as follows :

> "191. ***Property transferable by gift made in contemplation of death***.— (1) A man may dispose, by gift made in contemplation of death, of **any movable property** which he could dispose of by will.
>
> (2) A gift is said to be made in contemplation of death where a man, who is ill and expects to die shortly of his illness, delivers, to another the possession of any movable property to keep as a gift in case the donor shall die of that illness.

(3) Such a gift may be resumed by the giver, and shall not take effect if he recovers from the illness during which it was made; nor if he survives the person to whom it was made."

Two important requirements laid down in this sub-section are, (*i*) the donor must be ill and expects to die shortly of the illness, and (*ii*) possession of the property should be delivered to the donee, apparently during the lifetime of the donor. The requirement of 'delivery' is well-impressed in the three Illustrations given below section 191 of the Indian Succession Act, 1925, which read as follows :

"Illustrations :

(*i*) A, being ill, and in expectation of death, delivers to B, to be retained by him in case of A's death,—
a watch:
a bond granted by C to A:
a bank-note :
a promissory note of the Central Government endorsed in blank:
a bill of exchange endorsed in blank:
certain mortgage-deeds.

A dies of the illness during which he delivered these articles. B is entitled to—
the watch:
the debt secured by C's bond:
the bank-note:
the promissory note of the Central Government:
the bill of exchange:
the money secured by the mortgage-deeds.

(*ii*) A, being ill, and in expectation of death, delivers to B the key of a trunk or the key of a warehouse in which goods of bulk belonging to A are deposited, with the intention of giving him the control over the contents of the trunk, or over the deposited goods, and desires him to keep them in case of A's death. A dies of the illness during which he delivered these articles. B is entitled to the trunk and its contents or to A's goods of bulk in the warehouse.

(*iii*) A, being ill, and in expectation of death, puts aside certain articles in separate parcels and marks upon the parcels respectively the names of B and C. The parcels are not delivered during the life of A. A dies of the illness during which he set aside the parcels. B and C are not entitled to the contents of the parcels."

8. Whether Gift within prescribed limit of Rs. 50,000 as also from relatives and circumstances of exceptions, need to be proved:

It may be noted that there is no blank exemption in respect of Gift within prescribed limit of Rs.50,000 as also gifts from relatives and gifts received in circumstances of exceptions. In appropriate cases the department will be within its powers to treat even such unexplained or unproved gifts as cash credits or income u/s 68 of the Income Tax Act. Therefore the A.O. may require the assessee to discharge prima facie onus even in case of gifts within Rs.50,000 and gifts received on the occasion of marriage or from relatives.

9. Basis of computing deemed income:

The deemed income will be computed on the basis of the stamp duty value assessed or assessable in case of the immovable property and on the basis of Fair Market Value (FMV) **as on the date of receipt** in case of other specified assets. It covers in its ambit the purchase or receipt of immovable property as also other specified movable assets at an inadequate consideration.

Where an individual or HUF receives any immovable property resulting in benefit exceeding Rs.50,000 in a year, it would be chargeable to tax as income. The value 'assessed' or 'assessable' by the stamp duty valuation authority will be considered for the purposes of determining value of such immovable property. Immovable property for this purpose would mean land or building or both.

As per the wordings of the Section all transactions of purchase of immovable as well as specified properties would be covered under the section and, therefore, the provision would authorize the A.O. to raise issue in respect of every transaction of purchase of the specified property.

10. Stamp Duty Value to be adopted in case of Immovable Property:

Stamp duty value as is assessed or assessable by any authority or Central Government or State Government for the purpose of stamp duty is to be adopted. It is doubtful whether basis of valuation for the purpose of stamp duty has been notified by all the State Governments in respect of all the properties, including agriculture land etc. In case basis for valuation has not been notified for the purpose of stamp duty, the value taken would only be value as is mentioned in the documents registered or the value as would have been adopted by concerned authorities for the purpose of stamp duty. In the cases where documents have not been executed or registered, there are likely to be dispute in determination of assessable value in view of positive or negative aspects of a property.

In respect of immovable properties the A.O. has also been authorized to make reference to Valuation Officer. Accordingly, this would become a source of causing harassment to purchasers even in case of normal purchase transactions.

11. In case of receipt of immovable property which date will be reckoned as date of Receipt of Property:

a) An important issue relates to the date from which a gift or receipt of immovable property becomes effective. In case of gift whether it should be effective from the date of the execution of the gift deed and not necessarily from the date of its registration. The newly inserted provisions of section 56(2)(vii) have been made applicable from 1st October, 2009 in case the property is received by **any individual or a HUF**.

b) Gift is a word of common usage. It means giving away a thing on one's own volition. In technical terms a "gift" means the transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration in money or money's worth. Taxable gifts mean and include the transfer or conversion or giving away of any property without consideration.

c) Date of Receipt becoming effective for tax purposes : Income is to be considered u/s 56(2)(vii) in respect of gifts received or specified property received by an individual or HUF during the relevant previous year. When a person makes a gift of any movable property, the title to the said property passes to the donee **with the delivery of possession** of the property. **However, when a person makes a gift of immovable property by a deed executed in a previous year but registered in a subsequent year, the question arises whether the said gift is to be taxed in the previous year in which the gift deed was executed or in the previous year in which gift deed was registered. In other words, the question is whether the gift becomes effective from the date of registration of the document or from the date of execution of such deed.**

d) **Some legal aspects**: Gift has been defined in the Transfer of Property Act, 1882, as a transfer of certain existing movable or immovable property made voluntarily and without consideration by the donor to the donee. Section 123 of the Transfer of Property Act, 1882, provides that, for the purpose of making a gift of immovable property, the transfer must be effected by a registered instrument signed by or on behalf of the donor and attested by at least two witnesses. The Gift-tax Act, 1958 neither reiterated this rule nor provides any exception to it. Besides, **section 17(1)(a) of the Indian Registration Act, 1908, provides that an instrument of gift of immovable property requires registration under the said Act whatever be the value of the property. However, section 47 of the Indian Registration Act, provides that a registered document shall operate from the time from which it would have commenced to operate if no registration thereof had been required or made and not from the time of its registration. Under section 47, a registered document, thus, operates from the date of its execution and not from the date of its registration.**

e) **Some judicial decisions**: The Courts, while interpreting these provisions in the context of the question posed above, have come to different conclusions as under:

(i) In **T.V. Kalyanasundaram Pillai v. Karuppa Mooppanar AIR 1927 PC 42**, the Privy Council sought to reconcile the provisions of section 123 of the Transfer of Property Act with section 47 of the Indian Registration Act by saying that, while registration is a necessary solemnity for the enforcement of gift of immovable property, it does not suspend the gift until registration actually takes place. **When the instrument of gift has been handed over by the donor to the donee and accepted by him, the former has done every thing in his power to complete the donation and to make it effective. Registration does not depend upon his consent but is the act of an officer appointed by law for the purpose. The Privy Council took the view that the transaction of gift was complete on the date on which the document was executed and not on the date on which it was subsequently registered.**

(ii) In **Venkat Subba Srinivas Hegde v. Subba Rama Hegde AIR 1928 PC 86,** the point at issue was stated by the High Court which gave rise to the appeal before the Privy Council as under:

"Can a donor of immovable property, when the gift can only be effected by a registered document, resile from his action before the document had been registered and if the donee refused to give back the document, can the donor, obtain an injunction from the Court restraining the donee from proceeding to register the document?" (p. 87)

The Privy Council following its earlier decision in T.V. Kalyanasundaram Pillai's case (supra), reiterated the effect of registration in the following passage:

"Registration does not depend upon his (the donor's) consent, but is the act of an officer appointed by law for the purpose, who, if the deed is executed by or on behalf of the donor and is attested by at least two witnesses, must register it if it is presented by a person having the necessary interest within the prescribed period. Neither death, nor the express revocation by the donor, is a ground for refusing registration, if the other conditions are complied with." (p. 87)

In other words, the ratio of the decision is that the transaction of gift is complete if the other formalities are completed and the document of gift is executed and that **the donor cannot resile from his action before the document is registered**. The ratio of both the decisions of the Privy Council is to the effect **that a transaction of gift made by a document which is subsequently registered becomes operative from the date on which the document of gift was executed.**

(iii) Rajasthan High Court in **Sirehmal Nawalkha v. CIT [1985] 47 CTR (Raj.) 182**, has come to the same conclusion but on different reasons. In that case the assessee made a gift of certain out-houses belonging to him to his wife by a declaration in writing signed by him and his wife (donee). The-gift was not registered as required by section 17 of the Indian Registration Act, and section 123 of the Transfer of Property Act. The donee was in possession of the property gifted and had been exercising her rights as owner. **The assessee contended before the ITO that the gift was valid even though it was not registered.** The GTO rejected the contentions of the assessee and held that there was no valid gift. The AAC affirmed the order of the GTO. The Tribunal also dismissed the appeal filed by the assessee. However, the High Court on a reference held that **it was not necessary that one could become an owner of property only by a registered instrument**. Therefore, the Court held that there was a valid gift of the out-houses by the assessee to his wife in terms of the Gift-tax Act. The Court based its decision on the following reasons:

(a) The Gift-tax Act, is a self-contained code in itself.

(b) The concept of gift under the Gift-tax Act is much wider than that under the Act. A gift under section 2(xii) of the Gift-tax Act includes certain transfers detailed in section 4(1) and (2) of the Gift-tax Act. Many acts and transactions which do not amount to gift under the Transfer of Property Act amount to gift under the Gift-tax Act. **A gift which may be imperfect, invalid or void under the Transfer of Property Act may be**

a valid gift for the purposes of the Gift-tax Act if it falls within the definition of gift in the Gift-tax Act.

(c) It was not necessary that one could become an owner of property only by a registered instrument. **In the case of adverse possession, one become an owner without any registered document. The wife of the assessee was given physical possession of the property and she was exercising her rights as an owner without any interruption or objection for a long period. She had let out the out-houses and had been receiving rent, making repairs and had got water and electricity connections in her name, and she was paying wealth-tax on the property gifted. It could not be said that the action of the assessee was not bona fide because the rental income was assessed in his hands under section 64 of the Income-tax Act, 1961.**

A similar issue came before the Calcutta High Court for consideration in **CGT v. Smt. Aloha Lata Sett [1992] 103 CTR (Cal.) 343**.

Thus, from the above discussion, one may notice that the Courts have answered the question from different premises. The view taken by the Calcutta High Court that if the registered document is held to be effective against the revenue from the date of execution, it will entail great hardship because the revenue will have no knowledge of the date of execution of the document, does not appear to be tenable. On the contrary, it is submitted, that it is in the interest of revenue that the deed must be made effective from the date of execution so that it can be brought within the tax net at the earliest. It is in this direction that the Legislature has added an Explanation to section 2(xii) of the Gift-tax Act, recognizing title to the property without valid registration of immovable property to bring the deemed owner within the tax net. The counsel for the assessee should have referred to this Explanation to convince the Court that the registration of the immovable property is not essential for the ownership of property under the Gift-tax Act. In this regard, he should also have referred to the decision in Sirehmal Nawalkha's case (supra). It is to be remembered that the Gift-tax Act is a self-contained code. A gift which may be imperfect, invalid or void under the Transfer of Property Act may be valid gift for the purposes of the Gift-tax Act. The object of the Gift-tax Act is to levy tax on gift subject to the other provisions of the Act. Where a person makes gift; it is for him to comply with the provisions of the Act voluntarily. It is these considerations which rightly led the Rajasthan High Court to come to the conclusion that a gift of immovable properly under the Gift-tax Act comes into effect from the date of execution and not from the date of registration.

12. Fair Market Value/ Valuation of Jewellery:

As per Rule 11UA (a), the Valuation of Jewellery will be made on the following basis-

(i) the fair market value of jewellery shall be estimated to be the price which such jewellery would fetch if sold in the open market on the valuation date;

(ii) in case the jewellery is received by the way of purchase on the valuation date, from a registered dealer, the invoice value of the jewellery shall be the fair market value;

(iii)In case the jewellery is received by any other mode and the value of the jewellery exceeds rupees fifty thousand, then assessee may obtain the report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date;

13. **Meaning of Registered Dealer:**

As per **Rule 11U** (f) "registered dealer" means a dealer who is registered under Central Saletax Act, 1956 or General Sales-tax Law for the time being in force in any State including value added tax laws.

14. **Meaning of Registered Valuer:**

"Registered valuer" shall have the same meaning as assigned to it in section 34AB of the Wealth Tax Act, 1957(27 of 1957) read with rule 8A of wealth-tax Rules, 1957;

15. **Meaning of "valuation date"** : It means the date on which the respective property is received by the assessee.

16. Determining FMV for Archaeological collections, drawings, paintings etc:

As per Rule 11UA (b), the valuation of archeological collections, drawings, paintings, sculptures or any work of art, shall be determined as under-

(i) the fair market value of archeological collections, drawings, paintings, sculptures or any work of art (hereinafter referred as artistic work) shall be estimated to be price which it would fetch if sold in the open market on the valuation date;

(ii) in case the artistic work is received by the way of purchase on the valuation date, from a registered dealer, the invoice value of the artistic work shall be the fair market value;

(iii) in case the artistic work is received by any other mode and the value of the artistic work exceeds rupees fifty thousand, then assessee may obtain the report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date;

17. Concept of fair market value and Valuation with reference to judicial decisions:

The gift of the newly added properties is proposed to be taxed not at their cost, declared value or actual value but at the fair market value as on the date of gift or transfer. The fair market value in many cases might be more than the cost or actual value of these properties in the hands of the owner. To the extent of this difference there will be taxation of deemed gift in the hands of the recipient as his income under the head income from other sources.

Fair market value is a matter of opinion and is not a matter of fact. Fair market value is a subjective concept whereas cost being the actual value in the hands of the donor is a matter of fact. No two valuers ever agree on the fair market value of any property. Thus, the new provisions will not only lead to unfair taxation of a deemed gift but will also introduce uncertainties in the taxation of the gift and receipt of the said properties for alleged inadequate consideration. This provision based on fair market value involves subjective considerations and discretion in the hands of taxing authorities, its implementation will be difficult and involve enormous social cost.

Some Important Decisions on Valuation :

a) ***Valuation report is no useful material for rational belief as to suppression of real consideration that passes in a transaction*** **:** As held by the jurisdictional High Court in **ITO & others v. Santosh Kumar Dalmia 208 ITR 337 (Cal.),** the **question of valuation is a matter of opinion and valuation differs from valuer to valuer, depending on the facts and circumstances of each case. The valuer's report is after all a statistical hypothesis that leaves wide room for error on either side. It is no useful material for rational belief as to suppression of real consideration that passes in a transaction.**

b) ***Valuation report cannot by itself form the basis*** - Where apart from the valuation report which was relied upon by the ITO there was no material before him to come to the prima facie conclusion that the assessee had received a higher consideration than what had been stated in the sale deed, reassessment would not be justified - ITO v. Santosh Kumar Dalmia (Supra)

c) ***Opinion of an Engineer cannot be a material to entertain any belief that the petitioner has escaped income,*** therefore the authority concerned ought not to have reopened the assessment. **-Smt. Tarawati Debi Agarwal v. ITO [1986] 162 ITR 606/[1987] 30 Taxman 589 (Cal.)**

d) ***The valuation is always a question of opinion*** : The valuation is always a question of opinion and unless there is clear finding, on basis of material, that an assessee has invested in construction more than what has been shown by it in course of assessment proceedings, Assessing Officer cannot proceed merely on basis of valuation report of departmental valuer. Where petitioner's books of account were compulsorily audited and scrutinised and audited accounts gave presumption of its correctness duly supported by documents and vouchers. The reassessment proceedings initiated after more than four years, on basis of opinion obtained from an engineer about cost of construction, were, therefore, liable to be set aside. Hon'ble Justice Kalyan Jyoti Sengupta in **Kajaria Investment & Properties (P.) Ltd. v. Income-tax Officer [2001] 250 ITR 619 (Cal.) :[2003] 130 Taxman 301 (CAL.) [following the decision in** Smt. Tarawati Debi Agarwal v. ITO [1986] 162 ITR 606/[1987] 30 Taxman 589 (Cal.)]-copy of decision enclosed in **Annex-G**.

e) In **Vishnu Maruti Ghosale v. Appropriate Authority [2006] 285 ITR 459 (Bom.)** it was held that the very fact that there were various disadvantages attached to the property under consideration compared to the sale instance, itself was sufficient to hold that the sale instance property was not comparable with the property under consideration.

18. Receipt of shares and securities :

a) ***Bonus and Right Shares*** : As a result of section 56(2)(vii) the fair market value of Bonus Shares will be deemed the income of the concerned shareholder. Similarly the recipient of right shares will also be affected. In case of Bonus Shares, the taxpayers are really going to face a difficult time going by the present provisions. For example say Reliance Industries has issued Bonus Shares in the ratio of 1:1. Let us presume that prior to bonus the price of each share is Rs. 2,000 and Ex Bonus the price is 1,100. In such a case the value of two shares (original and bonus) is Rs. 2,200 against cost/ pre bonus price of Rs.2,000. The actual benefit is only Rs.200. But if the department takes only the FMV of the Bonus Share i.e. Ex bonus, the A.O. may consider income of Rs.1,100 per bonus share received by the assessee, ignoring the fact that the price of original share has diminished by Rs.900 per share due to issue of bonus shares. The CBDT really need to loom into these real life situation while making rules for determining fair market value of bonus as well as right shares.

b) **Private transaction in unlisted/ listed shares** : In case of transfer of shares and securities on private transaction basis, there can always be dispute regarding determination of fair market value. Many times transfer of shares can also be with the intention to transfer in the management or even effectively transfer of some immovable property held by the company. In such cases there would be litigation in order to determine the fair market value of such shares, even though rules may be prescribed by the Government.

c) **Shares received in ESOP** : What will be the position in case of Shares given to Employees under Employee Stock Option Plan (ESOP)/ Scheme. Whether it would be liable for tax as perk u/s 17(2) under the head salary or u/s 56(2)(vii). It may be noted that section 56(2)(vii) does not exclude shares received by an employee in pursuance of ESOP. Thus the present situation might lead to double taxation. Therefore an exclusion needs to be provided in section 56(2)(vii).

19. Valuation of Shares for the purpose of section 56(2) :
As per Rule 11UA(c) the valuation of shares and securities shall be done as under-

(a) **Fair market value of quoted shares and securities** : the fair market value of quoted shares and securities shall be determined in the following manner, namely;-

(i) if the quoted shares and securities are received by way of transaction carried out through any recognized stock exchange, the fair market value of such shares and securities shall be the transaction value as recorded in such stock exchange;

(ii) if such quoted shares and securities are received by way of transaction carried out other than through any recognized stock exchange, the fair market value of such shares and securities shall be,-

(a) the lowest price of such shares and securities quoted on any recognized stock exchange on the valuation date, and

(b) the lowest price of such shares and securities on any recognized stock exchange on a date immediately preceding the valuation date when such shares and securities were traded on such stock exchange, in cases where on the valuation date there is no trading in such shares and securities on any recognized stock exchange;

(b) **Fair market value of unquoted equity shares** : 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 namely;-

The fair market value of unquoted equity shares = (A-L) / (PE)
* (PV)

Where, A= Book value of the assets in Balance Sheet as reduced by any amount paid as advance tax under the Income-tax Act and any amount shown in the balance sheet including the debit balance of the profit and loss account or the profit and loss appropriation account which does not represent the value of any asset.

L= Book value of liabilities shown in the Balance Sheet but not including the following amounts:-

(i) the paid-up capital in respect of equity shares;

(ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;

(iii) reserves, by whatever name called, other than those set apart towards depreciation;

(iv) credit balance of the profit and loss account;

(v) any amount representing provision for taxation, other than amount paid as advance tax under the Income-tax Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;

(vi) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;

(vii) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares.

PE = Total amount of paid up equity share capital as shown in Balance Sheet.

PV = the paid up value of such equity shares.

(c) **Fair market value of other unquoted shares and securities** : the fair market value of unquoted shares and securities other than equity shares in a company which are not listed in any recognized stock exchange shall be estimated to be price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of such valuation.'.

20. **Some definitions :** As per Rule 11U of the Income Tax Rules, 1962, the meaning of certain terms are as under :

(a) "accountant" shall have the same meaning as assigned in the *Explanation* to section 288 of the Act;

(b) "balance-sheet", in relation to any company, means the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date;

(c) "merchant banker" means category I merchant banker registered with Security and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992;

(d) "quoted shares or securities" in relation to share or securities means a share or security quoted on any recognized stock exchange with regularity from time to time, where the quotations of such shares or securities are based on current transaction made in the ordinary course of business;

(e) "recognized stock exchange" shall have the same meaning as assigned to it in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956;

(h) "securities" shall have the same meaning as assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956;

(i) "unquoted shares and securities", in relation to shares or securities, means shares and securities which is not a quoted shares or securities;

(j) "valuation date" means the date on which the respective property is received by the assessee.

21. **Take care of provisions of section 27 in case of transfer of immovable property to spouse:**

Section 27 provides that for the purposes of sections 22 to 26, an individual who transfers **otherwise than for adequate consideration** any house property to his or her spouse, not being a transfer in connection with an agreement to live apart, or to a minor child not being a married daughter, shall be deemed to be the owner of the house property so transferred.

Therefore while making any transfer of such immovable property one need to be careful of the provisions of section 27 read with section 64.

Section 64 (1) (*iv*) provides that the in computing income of an individual there shall be included all such income as srises directly or indirectly, subject to the provisions of clause (*i*) of section 27, to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart.

22. Also take care of clubbing provisions:

a) In case of receipt of any property as gift or without consideration or at inadequate consideration, one should be careful about the clubbing provisions of section 64.

b) The provisions of following sub-clauses of section 64(1) provide that in computing the total income of any individual, there shall be included all such income as arises directly or indirectly—

"(*iv*) subject to the provisions of clause (*i*) of section 27, to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart ;

(vi) to the son's wife, of such individual, from assets transferred directly or indirectly on or after the 1st day of June, 1973, to the son's wife by such individual otherwise than for adequate consideration;

(vii) to any person or association of persons from assets transferred directly or indirectly otherwise than for adequate consideration to the person or association of persons by such individual, to the extent to which the income from such assets is for the immediate or deferred benefit of his or her spouse and

(viii) to any person or association of persons from assets transferred directly or indirectly on or after the 1st day of June, 1973, otherwise than for adequate consideration, to the person or association of persons by such individual, to the extent to which the income from such assets is for the immediate or deferred benefit of his son's wife."

For the purposes of clauses (*iv*) and (*vi*), where the assets transferred directly or indirectly by an individual to his spouse or son's wife (hereafter in this *Explanation* referred to as "the transferee") are invested by the transferee,—

(i) in any business, such investment being not in the nature of contribution of capital as a partner in a firm or, as the case may be, for being admitted to the benefits of partnership in a firm, that part of the income arising out of the business to the transferee in any previous year, which bears the same proportion to the income of the transferee from the business as the value of the assets aforesaid as on the first day of the previous year bears to the total investment in the business by the transferee as on the said day ;

(ii) in the nature of contribution of capital as a partner in a firm, that part of the interest receivable by the transferee from the firm in any previous year, which bears the same proportion to the interest receivable by the transferee from the firm as the value of investment aforesaid as on the first day of the previous year bears to the total investment by way of capital contribution as a partner in the firm as on the said day,

shall be included in the total income of the individual in that previous year.

c) Further section 64(1A) provides for inclusion in computing the total income of any individual, of all such income as arises or accrues to his minor child not being a minor child suffering from any disability of the nature specified in section 80U.

d) Section 64(2) provides that where, in the case of an individual being a member of a Hindu undivided family, any property having been the separate property of the individual has, at any time after the 31st day of December, 1969, been converted by the individual into property belonging to the family through the act of impressing such separate property with the character of property belonging to the family or throwing it into the common stock of the family or been transferred by the individual, directly or indirectly, to the family otherwise than for adequate consideration (the property so converted or transferred being hereinafter referred to as the converted property)], then, notwithstanding anything contained in any other provision of this Act or in any other law for the time being in force, for the purpose of computation of the total income of the individual under this Act for any assessment year commencing on or after the 1st day of April, 1971,—

(a) the individual shall be deemed to have transferred the converted property, through the family, to the members of the family for being held by them jointly ;

(b) the income derived from the converted property or any part thereof shall be deemed to arise to the individual and not to the family ;

(c) where the converted property has been the subject-matter of a partition (whether partial or total) amongst the members of the family, the income derived from such converted property as is received by the spouse on partition shall be deemed to arise to the spouse from assets transferred indirectly by the individual to the spouse and the provisions of sub-section (1) shall, so far as may be, apply accordingly :

Provided that the income referred to in clause (*b*) or clause (*c*) shall, on being included in the total income of the individual, be excluded from the total income of the family or, as the case may be, the spouse of the individual.

For the purposes of section 64(2), "property" includes any interest in property, movable or immovable, the proceeds of sale thereof and any money or investment for the time being representing the proceeds of sale thereof and where the property is converted into any other property by any method, such other property.

e) It is clear from the relevant provisions of these sections extracted above that it is not advisable to settle property either on the spouse or on the minor child as the transferor would continue to be the owner and liable to pay tax on the income emanating out of the asset which had been settled on these entities.

f) If any individual whether a male or a female being the owner of a self-acquired house property desires to sell the property and also to minimize capital gains tax, it is advisable for the individual to settle the same in favour of his children (other than minors) who would otherwise be entitled to this property on a later date retaining the designed portion including minors' share with the individual. By adopting this method capital gains gets distributed among all these persons (*i.e.*) settlor and settlees. The settlees who, thus, acquire the property under a settlement would be entitled to adopt the cost inflation index pertaining to the financial year in which the property was acquired by the previous owner (*i.e.*), the settlor. In such cases, each one of the settlees would also be entitled to take advantage of the provisions of section 54 and 54EC. However it is in the interest of the settlor not to settle the property either in favour of spouse or a minor child as any transfer made for inadequate consideration in such cases would attract tax only in the hands of the transferor.

g) It would be useful to keep in mind the provisions of section 2(24)(*xiii*) containing extended definition of the term 'income' and section 56(2)(*vi*)/(vii) of the Act which deals with taxation of money received from persons other than relatives in the hands of the assessee (beneficiary). The procedure of settling property in favour of children (other than minors) may be beneficial in cases where the property was acquired long back for a throw away price and the owner of the property being in his/her advanced age is likely to get huge price on sale of the property. Though settling the property in favour of the beneficiaries being relatives listed out in section 56(2)(*vi*) by the owner /settlor of the property retaining a portion of the property for himself/herself and the beneficiaries and the owner selling the property jointly is one of the recognized ways of tax planning so far as reducing capital gains tax is concerned, any transfer made by husband to wife and *vice versa* wife to husband and/or in favour of a minor child for inadequate consideration would attract income-tax only in the hands of the transferor.

h) The provisions for clubbing of income are complicated, so adequate precautions should be taken and proper tax planning is required to be done, to come out of the legal implications which the transferor of property may have to face. The observation of the Supreme Court in its decision in the case of **Sevantilal Maneklal Sheth v. CIT [1968] 68 ITR 503 (SC)** is relevant :.

> *"The object of the enactment of the section is to prevent avoidance of tax or reducing the incidence of tax on the part of the assessee by transfer of his assets to his wife or minor child. It is a sound rule of interpretation that a statute should be so construed as to prevent the mischief and to advance the remedy according to the true intention of the makers of the statute."*

i) Thus, chain of transactions may be resulting in taxation of income only in the hands of the transferor of property for inadequate consideration and it should be avoided.

23. **Firms and unlisted companies brought within the ambit of sec. 56(2)(viia)**: The Hon'ble FM has widened the scope of deemed income by bringing the **Firms and certain companies (in which public are not substantially interested) are** within the net of section 56(2)(viia) **w.e.f. 1.6.2010 in case they acquire shares of companies (in which public are not substantially**

interested) without consideration or at inadequate consideration. Section 2(18) of the Income tax Act defines **company in which public are not substantially interested, as under :**

"sec. 2(*18*) "company in which the public are substantially interested"- a company is said to be a company in which the public are substantially interested –

(*a*) if it is a company owned by the Government or the Reserve Bank of India or in which not less than forty per cent of the shares are held (whether singly or taken together) by the Government or the Reserve Bank of India or a corporation owned by that bank ; or

(*aa*) if it is a company which is registered under section 25 of the Companies Act, 1956; or

(*ab*)if it is a company having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by order of the Board to be a company in which the public are substantially interested :

Provided that such company shall be deemed to be a company in which the public are substantially interested only for such assessment year or assessment years (whether commencing before the 1st day of April, 1971, or on or after that date) as may be specified in the declaration ; or

(*ac*) if it is a mutual benefit finance company, that is to say, a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under section 620A of the Companies Act, 1956, to be a *Nidhi* or Mutual Benefit Society ; or

(*ad*) if it is a company, wherein shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than fifty per cent of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant previous year beneficially held by, one or more co-operative societies;

(*b*) if it is a company which is not a private company as defined in the Companies Act, 1956, and the conditions specified either in item (*A*) or in item (*B*) are fulfilled, namely :—

(*A*) shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) were, as on the last day of the relevant previous year, listed in a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956, and any rules made thereunder;

(*B*) shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than fifty per cent of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant previous year beneficially held by—

(*a*) the Government, or

(*b*) a corporation established by a Central, State or Provincial Act, or

(*c*) any company to which this clause applies or any subsidiary company of such company [if the whole of the share capital of such subsidiary company has been held by the parent company or by its nominees throughout the previous year.

Explanation.—In its application to an Indian company whose business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power, item (*B*) shall have effect as if for the words "not less than fifty per cent", the words "not less than forty per cent" had been substituted ;"

The above newly proposed provision of section 56(2)(viia) is an anti evasion measure in line with tax on deemed gifts in case of individuals and Hindu Undivided families. This provision has been introduced to prevent the practice of transferring unlisted shares / shares of private companies at prices much below their fair market value. However certain transactions are proposed to be excluded from the scope of the new provision viz. transactions undertaken for business reorganization, amalgamation and demerger which are not regarded as transfer u/s 47(via), (vic), (vicb) and (vii) of the Act. Consequential amendments have been made in sec. 2(24) to include the value of such shares/ or the difference of purchase price and fair market value, as the case may be, in the definition of income. Section 49 is also proposed to be amended to provide that the cost of acquisition of such shares will be the value which has been taken into account and has been subjected to tax under the provisions of section 56(2)(viia). In case of transfer of shares of such unlisted/ private companies without consideration or at prices below their fair market value, its valuation may be a contentious issue during assessments.

24. **Section 56(2)(vii) not to apply if the property is Stock-in-Trade in the hands of the recipient**: The definition of property is sought to be amended to provide that **sec. 56(2)(vii) will have application to the 'property' which is in the nature of a capital asset in the hands of the recipient**. It has now been made clear that the **provision will not apply to stock-in-trade, raw material and consumable stores in case of any business of such recipient**. The scope of deemed income is only to tax the transactions which are in kind and not the transactions entered into in the normal course of business or trade, the profits of which are taxable under specific head of income. The FM has done well by amending the definition retrospectively w.e.f. 1st October, 2009.

25. **Reference to Valuation Officer u/s 142A(1)**: It has been proposed to amend section 142A(1) w.e.f. 1.7.2010 to allow the A.O. to make a reference to the Departmental Valuation Officer (DVO) for making an estimate of the value of property for the purposes of section 56(2). The provision is enabling provision to give effect to the powers of the A.O. u/s 56(2)(vii)/(viia). However the taxpayers may feel its heat during scrutiny assessments.

26. **Conclusion:**

The provisions of section 56(2)(vii) are complicating tax provisions. Determination of FMV of the specified movable properties such as jewellery, archeological collections, drawings, paintings, sculptures and work of art, will be subject to valuation which will differ from valuer to valuer. Taxation on deemed basis and fair market value concept is not a tax payers friendly measure, when such taxation measures introduced in the past have failed the legal scrutiny by the Apex Court and eventually dropped. The objection is to the manner in which the value of the gift is proposed to be determined. It may be worthwhile to note that Contract between two parties for transferring any asset or right in asset, as per the Indian Contract Act, 1872 has lost its essence as far as taxation under the Income-tax Law is concerned. The better approach for the legislature may be to take the value of the proposed gifts at their cost or actual value in the hands of the donor or consider revival of the Gif-tax Act. One may remember the introduction of Service Tax with only a few services which later has been increased to over 100 services. Now, we need to watch out, whether Legislature will further widen the ambit of movable properties for the purposes of sec. 56(2) or restrict it to the present amendment.

TO BE PUBLISHED IN THE GAZETTE OF INDIA EXTRAORDINARY, PART-II, SECTION 3,SUB-SECTION (II)

GOVERNMENT OF INDIA, MINISTRY OF FINANCE
DEPARTMENT OF REVENUE (CENTRAL BOARD OF DIRECT TAXES)

New Delhi, the 8th April, 2010
NOTIFICATION
[INCOME-TAX]

S.O……(E) .- In exercise of the powers conferred by section 295 of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby makes the following rules further to amend the Income-tax Rules, 1962, namely:-

1. Short title and commencement. - (1) These rules may be called Income-tax (Second Amendment) Rules, 2010.
(2) They shall come into force from the 1st day of October, 2009.

2. Insertion of new rules. - In the Income-tax Rules, 1962, after the sub-part G, the following shall be inserted, namely:-

'H. - Determination of fair market value of the property other than immovable property

11U. Meaning of expressions used in determination of fair market value. For the proposes of this rule and rule 11UA,-
(a) "accountant" shall have the same meaning as assigned in the *Explanation* to section 288 of the Act;
(b) "balance-sheet", in relation to any company, means the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date;
(c) "merchant banker" means category I merchant banker registered with Security and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);
(d) "quoted shares or securities" in relation to share or securities means a share or security quoted on any recognized stock exchange with regularity from time to time, where the quotations of such shares or securities are based on current transaction made in the ordinary course of business;
(e) "recognized stock exchange" shall have the same meaning as assigned to it in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);
(f) "registered dealer" means a dealer who is registered under Central Saletax Act, 1956 or General Sales-tax Law for the time being in force in any State including value added tax laws;
(g) "registered valuer" shall have the same meaning as assigned to it in section 34AB of the Wealth Tax Act, 1957(27 of 1957) read with rule 8A of wealth-tax Rules, 1957;
(h) "securities" shall have the same meaning as assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);
(i) "unquoted shares and securities", in relation to shares or securities, means shares and securities which is not a quoted shares or securities;
(j) "valuation date" means the date on which the respective property is received by the assessee.

11UA. Determination of Fair Market Value. - For the purposes of section 56 of the Act, the fair market value of a property, other than immovable property, shall be determined in the following manner, namely,-

(a) valuation of Jewellery.-

(i) the fair market value of jewellery shall be estimated to be the price which such jewellery would fetch if sold in the open market on the valuation date;

(ii) in case the jewellery is received by the way of purchase on the valuation date, from a registered dealer, the invoice value of the jewellery shall be the fair market value;

(iii) In case the jewellery is received by any other mode and the value of the jewellery exceeds rupees fifty thousand, then assessee may obtain the report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date;

(b) valuation of archeological collections, drawings, paintings, sculptures or any work of art.-

(i) the fair market value of archeological collections, drawings, paintings, sculptures or any work of art (hereinafter referred as artistic work) shall be estimated to be price which it would fetch if sold in the open market on the valuation date;

(ii) in case the artistic work is received by the way of purchase on the valuation date, from a registered dealer, the invoice value of the artistic work shall be the fair market value;

(iii) in case the artistic work is received by any other mode and the value of the artistic work exceeds rupees fifty thousand, then assessee may obtain the report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date;

(c) valuation of shares and securities.-

(a) the fair market value of quoted shares and securities shall be determined in the following manner, namely;-

(i) if the quoted shares and securities are received by way of transaction carried out through any recognized stock exchange, the fair market value of such shares and securities shall be the transaction value as recorded in such stock exchange;

(ii) if such quoted shares and securities are received by way of transaction carried out other than through any recognized stock exchange, the fair market value of such shares and securities shall be,-

(a) the lowest price of such shares and securities quoted on any recognized stock exchange on the valuation date, and

(b) the lowest price of such shares and securities on any recognized stock exchange on a date immediately preceding the valuation date when such shares and securities were traded on such stock exchange, in cases where on the valuation date there is no trading in such shares and securities on any recognized stock exchange;

(b) 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 namely;-

The fair market value of unquoted equity shares = (A-L) / (PE)
* (PV)

Where, A= Book value of the assets in Balance Sheet as reduced by any amount paid as advance tax under the Income-tax Act and any amount shown in the balance sheet including the debit balance of the profit and loss account or the profit and loss appropriation account which does not represent the value of any asset.

L= Book value of liabilities shown in the Balance Sheet but not including the following amounts:-

(i) the paid-up capital in respect of equity shares;
(ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
(iii) reserves, by whatever name called, other than those set apart towards depreciation;
(iv) credit balance of the profit and loss account;
(v) any amount representing provision for taxation, other than amount paid as advance tax under the Income-tax Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;
(vi) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
(vii any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares.

PE = Total amount of paid up equity share capital as shown in Balance Sheet.

PV = the paid up value of such equity shares.

(c) the fair market value of unquoted shares and securities other than equity shares in a company which are not listed in any recognized stock exchange shall be estimated to be price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of such valuation.'.

Notification No 23/2010
[F.No.142/21/2009-SO (TPL)
(Ashish Kumar)
Director (Tax Policy and Legislation)

Note. The principal rules were published, vide, Notification No. S.O. 969(E), dated the 26th March 1962 and last amended by Income-tax (First Amendment) Rules, 2010 vide Notification S.O. No. 424 (E) dated 18th February, 2010**.**