

THE POWER
OF BEING
UNDERSTOOD

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NEWSFLASH: CBDT NOTIFIES RULES REGARDING 'INDIRECT TRANSFER' PROVISIONS

**-Fair market value and reporting requirements for Indian concern
(Notification No. 55 of 2016 dated 28 June 2016)**

THE POWER OF BEING UNDERSTOOD



1.0 Background

- 1.1 Presently, any capital gains arising to a non-resident on indirect transfer of shares is deemed to accrue or arise in India on account of 'retrospective amendment' carried out through Finance Act, 2012.
- 1.2 Thus currently, India taxes capital gains arising to a non-resident on transfer of shares of a foreign company if such shares derive its value substantially from the assets¹ located in India:
- the fair market value (FMV) of assets located in India exceeds Rs. 10 crores, and
 - FMV of assets located in India represents at least 50% of FMV of total assets of the foreign company or entity.
- 1.3 For the operationalization of the above, the following were to be prescribed:
- the manner of computation of fair market value (FMV) of Indian and global assets of the foreign company or entity,
 - determination of income attributable to assets situated in India, and
 - information or documents required to be maintained and furnished by the Indian concern under section 285A of the Income Tax Act ('the IT Act')
- 1.4 In this regard, the Central Board of Direct Taxes (CBDT) had released draft rules on 23 May 2016, which were available for comments and suggestions from stakeholders and general public upto 29 May 2016.
- 1.5 After due consideration of the comments received, the CBDT has notified final Rules relating to "indirect transfer" on 28th June 2016 and which are applicable from 28th June 2016.

2.0 Coverage

New Rules / Forms	What it provides for?
Rule 11UB	Determination of fair market value (FMV) of Indian assets and global assets of foreign company
Rule 11UC	Determination of income attributable to assets in India
Form No. 3CT	Transferor to obtain and furnish along with the return of income an accountant report in Form No. 3CT
Rule 114DB	Information or documents to be furnished by an Indian concern through or in which the Indian assets are held by the foreign company
Form No. 49D	Indian concern to furnish information in Form No. 49D electronically under digital signature within specified time limit.

¹ *Inserted vide amendment in Finance Act 2015*

3.0 Determination of FMV of Indian Assets and Global Assets of Foreign Company [Rule 11UB]

The determination of FMV of assets is one of the critical factors for analyzing applicability of 'indirect transfer' provisions under the IT Act. Rule 11UB specifies the manner of determination of FMV of assets located in India as well as the FMV of global assets of the foreign company or entity.

3.1 FMV of assets located in India

The valuation methodology for arriving at the FMV has been specified depending on the type of assets located in India as under:

Asset is a listed share

- FMV = Observable price of such share on the stock exchange on specified date
- Where share is held as part of shareholding confers any right of management or control in the company, **FMV = (A+B)/C**, where
A= Market capitalization of the Co on the basis of observable price,
B= Book Value of liabilities of Co on specified date

Asset is unlisted share

- FMV on specified date as determined by MB / accountant as per any internationally accepted valuation methodology for valuation of shares on arm's length basis as increased by liability, if any, considered in such determination

Asset is in the form of interest in a firm/AOP

- Determination of FMV is a two-step process
- Firstly, determining the FMV of total firm/AOP on the specified date as determined by *MB/accountant
- Secondly, apportioning the above value amongst partners or members in specified manner (Refer Note 2)

Other asset

- FMV shall be the price it would fetch if sold in the open market on the specified date as determined by *MB/accountant as increased by liability, if any, considered in such estimation

*MB= Merchant Banker

Note 1:

If the share is listed on more than 1 stock exchange, observable price to be considered shall be in respect of the stock exchange which records the highest volume of trading in the share during the period which is considered for determining the price.

Note 2:

Determination of FMV of asset in the form of interest in a firm / AOP is a two-step process.

Step 1: Determine FMV of the total firm / AOP

FMV shall be value on the specified date as determined by MB/accountant as per any internationally accepted valuation methodology as increased by liability, if any, considered in such determination.

Step 2: Allocate the FMV arrived at Step 1 among its partners of members

Total amount allocated to a partner/member shall be **aggregate** of the following:

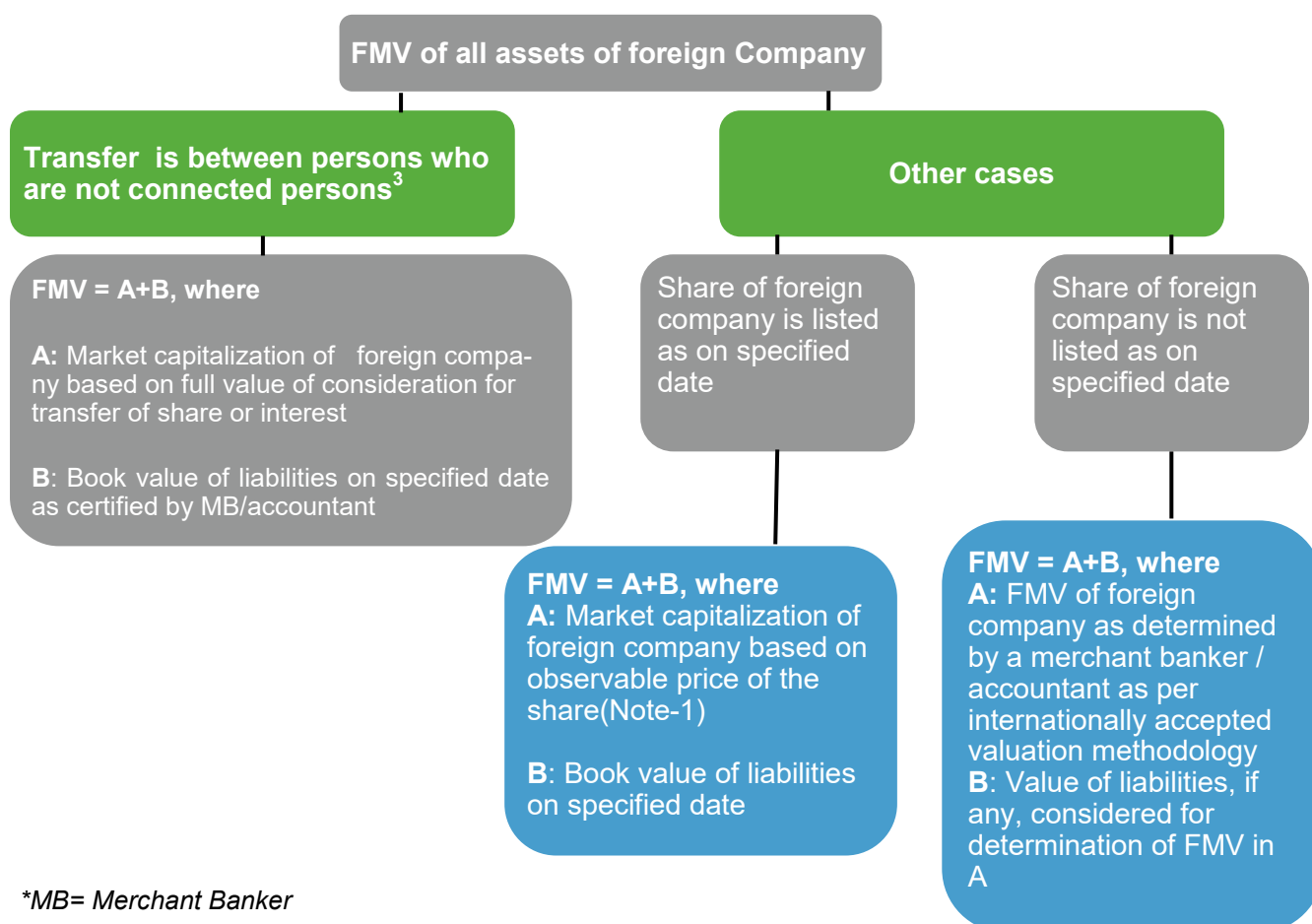
- The portion of the value as computed in Step 1 as is equal to the total capital shall be allocated amongst partners/members in capital contribution ratio.
- Balance amount shall be allocated in dissolution ratio/profit sharing ratio amongst partners/members.

Note 3: For determining FMV of a share of an Indian company or interest in a partnership firm or AOP, all the assets and business operation of the company/partnership firm or AOP shall be considered irrespective of whether the assets or business operations are located in India or outside India.

Note 4: 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 on specified date.

3.2 FMV of all assets of the foreign company²

FMV of all assets of the foreign company shall be determined in the following manner:



*MB= Merchant Banker

² The rule is also applicable to a foreign entity other than company.

³ Under the draft Rule, reference was made to 'associated persons'. In the final rules, it has now been replaced with 'connected persons'. The definition of connected persons (see 'Definitions' section in this newsflash) has been imported from the General Anti-Avoidance Rule (GAAR).

Note 1: If the share is listed on more than 1 stock exchange, observable price to be considered shall be in respect of the stock exchange which records the highest volume of trading in the share during the period which is considered for determining the price.

4.0 Determination of income attributable to assets in India [Rule 11UC]

The IT Act provides that in cases of income arising on indirect transfer of shares of foreign company where all the assets owned by the foreign company which derive substantial value from India are not located in India; only proportionate income as can be reasonably attributed to assets in India will be taxable.

4.1 Manner of attribution of income

The manner of attribution has been specified in new Rule 11UC. It specifies that the taxable income in India shall be that proportion of the total income which FMV of Indian assets bears to FMV of the global assets of the foreign company or entity.

Where the transferor of the share of the company fails to provide the information which is necessary for the aforesaid calculation then taxable income shall be determined in such manner as the Assessing Officer may deem suitable.

4.2 Reporting obligation on transferor

The transferor would be required to furnish along with the return of income, a report in Form No. 3CT duly signed and verified by an accountant. The report of an accountant would provide the basis of the apportionment in accordance with the formula and certify that the income attributable to assets located in India has been correctly computed.

5.0 Information or documents to be furnished by an Indian concern [Rule 114DB]

Section 285A of the IT Act mandates reporting requirement on the Indian concern through or in which the foreign company or entity holds the assets in India.

5.1 Procedure for furnishing information

The information is required to be furnished by filing Form No. 49D electronically under digital signature to the Assessing Officer within 90 days from the end of the financial year in which transfer takes place (within 90 days⁴ from the date of transaction where it involves the direct or indirect transfer of the right of management or control of Indian concern).

5.2 Details of documents to be maintained by the Indian concern

The Indian concern shall maintain the following documents/details (*an English translation has to be prepared if the documents originally prepared are in foreign languages*):

- Details of the immediate holding company or entity, intermediate holding company or companies or entity or entities and ultimate holding company or the entity of the Indian concern
- Details of other entities in India of the group of which the Indian concern is a constituent
- Holding structure of the shares of, or the interest in, the foreign company or entity before and after the transfer
- Any transfer contract or agreement entered into in respect of the share of, or interest in, any foreign company or entity that holds any asset in India through, or in, the Indian concern
- Financial and accounting statements of the foreign company or the entity which directly or indirectly holds the assets in India through, or in, the Indian concern for 2 years prior to the date of transfer of the share or interest
- Information relating to the decision or implementation process of the overall arrangement of the transfer;

⁴ Time limit for furnishing for furnishing Form 49D has been relaxed from 30 days from the date of transaction as provided in the draft rules to 90 days from the date of transaction in the final rules.

- Information in respect of the foreign company and its subsidiaries relating to -
 - Business operation;
 - Personnel;
 - Finance and properties;
 - Internal and external audit or the valuation report, if any, forming basis of the consideration in respect of share, or the interest
- Asset valuation report and other supporting evidence to determine the place of location of the share or interest being transferred;
- Details of payment of tax outside India, which relates to the transfer of the share or interest;
- Valuation report in respect of Indian assets and total assets duly certified by a merchant banker or accountant with supporting evidence;
- Documents which are issued in connection with the transactions under the accounting practice followed.

5.3 Documentation to be maintained for 8 years

The information is required to be maintained by Indian concern for 8 years from the end of relevant assessment year.

KEY DEFINITIONS

1 Accountant

In India: Practicing Chartered Accountant

Outside India: Valuer recognised for undertaking similar valuation by the Government of the country where the foreign company is registered/incorporated if the following conditions are fulfilled:

- If he is a member or partner in any entity engaged in rendering accountancy/valuation services then-
 - If entity or its affiliates has presence in more than 2 countries, and
 - Annual receipts of that entity in the year preceding the year in which valuation is undertaken is more than Rs. 100 million.
- If he is pursuing the profession of accountancy individually or is a valuer then
 - His annual receipts in the year preceding the year in which valuation is undertaken is more than Rs. 10 million, and
 - Professional Experience of at least 10 years

2 Connected Person

Connected person means any person who is connected directly or indirectly to another person and includes

Status of 'Person'	Connected Person
Individual	Any relative of the individual
Company	Director of the company or any relative of such director
Firm / BOI / AOP	Any partner / member of such firm / AOP / BOI or any relative of such partner / member
HUF	Any member or relative of such member of HUF
Any Person	Any individual with substantial interest in the business of such person or relative of such person
	Company / Firm / BOI / AOP / HUF having substantial interest in business of such person or
	Any director, partner, or member of the Company/Firm/ AOP/BOI or family, or Any relative of such director, partner or member
Any other person who carries on a business	Company / Firm / AOP / BOI / HUF whose Director / Partner / Member or any family / relative of such Director / Partner / Member having substantial interest in the business of the Person
	Individual or any relative of such individual having a substantial interest in the business of such other person or
	Company / Firm / HUF / BOI / AOP or their Director / Partner / Member or any relative of such Director / Partner / Member having substantial interest in the business of such person.

3 Balance Sheet

In case of an Indian Company: Balance sheet (including notes annexed thereto and forming part of the accounts) as drawn up on the specified date which has been audited as per laws relating to companies in force.

In case of any foreign company/entity:

Balance sheet (including the notes annexed thereto and forming part of the accounts) as drawn up on specified date submitted to relevant authority outside India under the laws in force of that country in which the company is registered/incorporated.

However, in both cases, if on the specified date, balance sheet is not drawn up, pending finalization of accounts, the balance sheet shall mean an interim balance sheet drawn up as on the specified date and approved by the board of directors of the company or equivalent body in case of other entity.

If the specified date is the date of transfer, balance sheet would mean the balance sheet as drawn up on the specified date and certified by an accountant on the date of transfer.

4 Observable price

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

- Average of weekly high and low of closing prices of the shares quoted on the said stock exchange during 6 months period preceding the specified date; or
- Average of weekly high and low of closing price of the shares quoted on the said stock exchange during 2 weeks preceding the specified date

5 Specified date means the

- a. Date on which the accounting period of the company/entity ends preceding the date of transfer of a share or an interest OR
- b. Date of transfer if, the book value of the assets of company/entity on the transfer date exceeds the book value of assets on the date referred in (a) above, by 15%.

6 Book value of the liabilities

Book value of the liabilities means the value of liabilities as shown in the balance-sheet of the company/ entity as the case may be, excluding the paid-up capital in respect of equity shares or members' interest and the general reserves and surplus and security premium related to the paid up capital.

7 Right of management or control

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.

8 Merchant banker and recognised stock exchange

The terms "merchant banker" and "recognised stock exchange" shall have the meaning as assigned to them in rule 11U.

As per Rule 11U, merchant banker means category I merchant banker registered with Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992).

As per Rule 11U, recognized stock exchange shall have the same meaning as assigned to it in clause (f) of section 25 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956).

9 Constituent entity

Constituent Entity shall have the meaning as assigned to it in clause (d) of sub-section (9) of section 286. As per section 286(9)(d), constituent entity means:

- i) any separate entity of an international group that is included in the consolidated financial statement of the said group for financial reporting purposes, or may be so included for the said purpose, if the equity share of any entity of the international group were to be listed on a stock exchange;
- ii) any such entity that is excluded from the consolidated financial statement of the international group solely on the basis of size or materiality; or
- iii) any permanent establishment of any separate business entity of the international group included in clause (i) or clause (ii), if such business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting or internal management control purposes.

10 Group

Group shall have the meaning as assigned to it in clause (e) of sub-section (9) of section 286. As per section 286(9)(e), group includes a parent entity and all the entities in respect of which, for the reason of ownership or control, a consolidated financial statement for financial reporting purposes,

- i) is required to be prepared under any law for the time being in force or the accounting standards of the country or territory of which the parent entity is resident; or
- ii) would have been required to be prepared had the equity shares of any of the enterprises were listed on a stock exchange in the country or territory of which the parent entity is resident.

11 Intermediate holding company or entity

Intermediate holding company or entity means a company or an entity that has controlling interest in another company or entity and is itself controlled by, or is subsidiary of, another company or entity.

12 Immediate holding company or entity

Immediate holding company or entity means the company or the entity that directly maintains the controlling interest in the Indian concern.

13 Ultimate holding company or entity

Ultimate holding company or entity means a company or an entity that has ultimate control of the Indian concern directly or indirectly and such company or entity is not itself controlled by, or is subsidiary of, any other company or entity.



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5 July 2016

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