Only Fair Market Value – Not More and Not Less

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One of the famous quotes from Warren Buffet *'Long ago, Ben Graham taught me that Price is what you pay; Value is what you get'*. This statement is true not only from investor viewpoint but also from taxman viewpoint!

Income Tax Act, 1961 ('Act') contains provisions which focus primarily on value rather than nature of receipt, whether revenue or capital. Sec 2(22B) of the Act has defined the term 'Fair Market Value' (FMV) in relation to Capital Asset. However, reference to FMV is made in the Act in various scenarios and not limited to capital asset only though it was defined for such.

Receipt more than FMV:

Finance Act 2012 has inserted clause (viib) to Section 56 (2) with effect from 01.04.2013, which provides for chargeability of share premium received from a person[1] who is resident in the hands of a company in which public are not substantially interested, under the head income from other sources. Though the receipt is not in the nature of income, it was made taxable from Assessment Year 2013-14. The amendment which brought insertion of new clause was as part of measures to prevent generation and circulation of unaccounted money[2].

Income is chargeable to the extent the amount received as a consideration for shares exceeds FMV of shares. FMV for this purpose would be highest of value of share determined as per the rules[3] or as may be substantiated by the company to the satisfaction of AO.

To attract the provisions of Sec 56(2)(viib) the following conditions are to be satisfied:

1. A company in which public are not substantially interested has issued shares for consideration;
2. Shares are issued at a premium;
3. Consideration for shares is received from resident[4];
4. The consideration received is in excess of FMV of shares.
5. Company has not able to substantiate the excess receipt with reference to FMV i.e the grounds for issue price which is in excess of FMV.

The provisions of Sec 56(2)(viib) shall not apply[5] to a 'Start Up' which complies with the conditions mentioned below:

(1) The Eligible Start up is a Pvt Ltd Company;
(2) The aggregate paid up capital and share premium after the proposed issue does not exceed Rs. 10 Crores;

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[1] As defined under Section 2(31)
[2] As referred to in Memorandum to FA 2012.
[3] Rule 11U and 11UA.
[4] Not necessarily from the same person
[5] Notification dated 11/04/2018

(3) The investor or proposed investor, who propose to subscribe to the issue of shares of the start-up has (i) Avg. returned income of Rs. 25 Lakhs or more in the preceding three financial years or (ii) Net worth of Rs. 2 Crores or more on the last date of preceding financial year;

(4) Start up has obtained a report from a Merchant Banker specifying the FMV of the shares as per the Rule 11UA of the Income-tax Rules, 1962.

Application[6] has to be made to the Board for getting relief from applicability of provisions of Sec 56(2)(viib).

Receipt less than FMV:

Sec 56(2)(X) provides taxability of income in case any person receives from any other person any property (which includes shares and securities) either without consideration or for consideration less than FMV subject to base limit of Rs. 50,000/-. Exceptions are provided for receipts from specified persons i.e. relatives etc. However, unlike sec 56(2)(viib) non-resident is not excluded for this purpose.

This section does not require the receipt should be for issue of shares. If shares of private limited company are purchased for less than FMV the difference between FMV of the share and amount paid will be treated as income in the hands of recipient for the purpose of this section.

Difference between provisions of Sec 56(2)(viib) and (X) are tabulated as follows:

Particulars	**Sec 56(2)(viib)**	**Sec 56(2)(X[7])**
Applicability	A Company in which public are not substantially interested	Receipt by person from another person
Trigger Point	Amount received for issue of shares from a person, who is resident, is more than FMV	Shares are received without consideration or for a consideration paid which is less than FMV subject to limit of Rs. 50,000
Non-applicability	Amount ***received*** by Venture Capital Undertaking from Venture Capital Fund/Venture Capital Company/ Amount received ***from*** Non-resident/ Amount received from an Investor by an Eligible Start -up subject to conditions	Shares are received from relatives/ on occasion of marriage/under a will or inheritance/ on contemplation of death of payer or donor/ Local Authority/ Charitable trust etc
Taxable Component	Amount received in excess of FMV of shares	Amount of FMV, in case where no consideration paid or the difference between FMV of share and amount paid subject to amount of Rs. 50,000/-

[6] Form 2
[7] With reference to shares only