Dichotomy in Valuation of Preferential Issue of Unquoted Equity Shares

Jan 24, 2023

Alok Kalani

Executive Director, Corporate Finance, RPSG Group

1. Section 62(1)(c) of the Companies Act, 2013 read with Rule 13 of The Companies Rules, 2021 mandates issue of unquoted equity shares on a preferential basis at a price determined on the basis of a true and fair value of the shares determined by a registered valuer. The basis of valuation has been prescribed in the valuation standards notified under Rule 18 of The Companies (Registered valuers and Valuation) Rules, 2017. These standards prescribe calculation of issue price on a fair value basis i.e. similar to calculation prescribed in Rule 11UA(1) of the Income-tax Rules, 1961 ('IT Rules').

2. Section 56(2)(viib) of the Income-tax Act, 1961 ('IT Act') dictates that any consideration for shares issued by a company, in which public are not substantially interested, that exceeds the fair market value of the shares would be considered as income in the hands of the issuer company. The fair market value being higher of the following:

- Value as determined in accordance with Rule 11UA(2) of IT Rules;
- Value as may be substantiated by the company to the satisfaction of Assessing Officer.

3. Rule 11UA(2) of the IT Rules prescribes that value of unquoted shares should be on the basis of book value.

4. Thus, for an unlisted company having sizeable fixed assets being land and building and other investments carried in the books on historical cost basis, there is an inherent difference between the calculation of issue price of equity shares on fair value basis as per the provisions of Companies Act, 2013 vis-à-vis book value basis as per Rule 11UA(2) of the IT Rules.

5. Such difference, in valuation methodology in two statutes leading to lot of confusion and being prone to litigation, needs appropriate resolution.

** views expressed are personal & may not reflect that of my organisation.*