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Representations on relieving retrospective adverse impact of Rule 11UAE and providing opportunity to taxpayer to rebut normative Rule 11UAE in bonafide circumstances

Background

Finance Act 2021 amended the definition of 'slump sale' as per section 2(42C) of the Income-tax Act, 1961 (IT Act) to include transfer of the undertaking by any means. This was primarily intended to cover slump exchange transactions. The amendment was proposed effective from A.Y. 2021-22 (F.Y. 2020-21) onwards. At the Bill stage, no amendment was proposed to s.50B which provides for methodology of computation of capital gains on slump sale.

However, at enactment stage, further amendment was carried out to s.50B(2) to provide that fair market value (FMV) of the undertaking as on the date of transfer, calculated in the prescribed manner, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the undertaking. There was no clarification provided on the policy rationale for this amendment at enactment stage. This amendment was also made effective from A.Y. 2021-22 (F.Y. 2020-21) onwards.

The Finance Act 2021 received Presidential assent on 28 March 2021.

It was expected that the rule to compute FMV of the undertaking may be notified immediately on 1 April 2021 to align with effective date of amendment made by Finance Act 2021. However, there was no such notification on 1 April 2021. Hence, the industry expected the Government to publish the draft rule for computing FMV for stakeholder consultation.

If the amendment was merely intended to provide a valuation rule for valuing consideration received in slump exchange (where shares are received by seller entity), it was reconcilable with the amendment made to s.2(42C).

However, surprisingly, the CBDT notified Rule 11UAE on 24 May 2021 vide Notification No. 68/2021 dated 24 May 2021 without any prior stakeholder consultation. Furthermore, unlike customary practice of clarifying the effective date of the Notification/amendment, there is nothing mentioned in Notification No. 68/2021 about the effective date of insertion of Rule 11UAE.

Furthermore, apart from valuation rule for valuing consideration received in slump exchange, Rule 11UAE also brings an 'anti-abuse' provision for conventional slump sale as explained below.

Rule 11UAE provides for adoption of higher of FMV1 or FMV2 as FMV of the undertaking for computing capital gains on slump sale. The first component of FMV1 looks at value of undertaking based on existing valuation rules for s.56(2)(x)/50CA read with Rule 11UA and adopts a partial 'look through' approach where values of certain assets & liabilities are adopted as per books of account and certain specified assets are valued as per fair

valuation criteria (like stamp duty ready reckoner value for immovable property or listed shares are valued based on stock exchange quotation).

The second component of FMV2 looks at monetary and non-monetary consideration received for transfer of the undertaking. The consideration in the form of unlisted shares is to be valued as per partial 'look through' approach as applicable for s.56(2)(x)/50CA read with Rule 11UA.

The FMV as per Rule 11UAE can be higher than actual consideration in certain circumstances. For instance, FMV1 based on book value of the undertaking may be higher than monetary consideration received. This can pose challenge where the undertaking is bonafide transferred at its true commercial value which is lower than Rule 11UAE value. There is no opportunity provided in the rule for the taxpayer to rebut such notional valuation.

The new Rule 11UAE raises concern for the industry with reference to its effective date and lack of opportunity to rebut the normative valuation which are explained below.

1. **Issue – Concern on possible retrospective application of Rule 11UAE to A.Y. 2021-22**

   The amendment to s.50B(2) was made by Finance Act 2021 w.e.f A.Y. 2021-22 onwards. However, Rule 11UAE was notified on 24 May 2021 but the Notification No. 61/2021 is silent on the effective date of the new rule.

   It is well settled legal position that law applicable on first day of April of the assessment year is law applicable for the whole of the previous year relevant to such assessment year. This position is brought out very clearly in multiple rulings of the Supreme Court like Isthmian Steamship Lines [1951] 20 ITR 572 (SC) (3 Judge Bench), Karimatharuvi Tea Estate Ltd v State of Kerala [1966] 60 ITR 262 (SC) (Constitution Bench), Reliance Jute & Industries Ltd [1979] 120 ITR 921 (SC) (2 Judge Bench), Shah Sadiq & Sons [1987] 166 ITR 102 (SC) (2 Judge Bench) and Shree Choudhary Transport Company [2020] 426 ITR 289 (SC) (2 Judge Bench).

   Since Rule 11UAE was notified on 24 May 2021, it should be applicable, if at all, for transactions consummated on or after 24 May 2021 or at the highest from A.Y. 2022-23 onwards.

   But Notification No. 61/2021 does not mention any effective date of applicability. This can give rise to litigation if field officers seek to apply Rule 11UAE to slump sale concluded during A.Y. 2021-22. This possibility arises where Rule 11UAE value is higher than actual consideration agreed between the parties.

   Any such interpretation will result in retrospective application of Rule 11UAE and levy of tax on retrospective basis. This is contrary to mandate of s.295(4) which provides that although CBDT has power to give retrospective effect to rules, no retrospective effect shall be given to any rule so as to prejudicially affect the interests of the assesses, unless the contrary is permitted (whether expressly or by necessary implication).

   While the courts will certainly interpret that Rule 11UAE has prospective effect, a specific clarification to that effect by CBDT will avoid unnecessary litigation on the issue.

Representation

To avoid any unwarranted litigation, it may be expressly clarified that Rule 11UAE will not be applicable to A.Y. 2021-22 since it was notified on 24 May 2021. Alternatively, Rule 11UAE may be made optional to taxpayers in relation to A.Y. 2021-22.

2. Issue - Relief from retrospective application of Rule 11UAE for transactions which were publicly announced by 24 May 2021 but are consummated after 24 May 2021

As stated earlier, amendment to s.50B(2) was not originally proposed in Finance Bill 2021. It was introduced on 23 March 2021 by the Finance Minister while replying to the debate on the Bill in Lok Sabha. The Finance Act 2021 received President's assent on 28 March 2021.Rule 11UAE was notified on 24 May 2021. The industry was, therefore, caught by surprise.

There was no prior public consultation before notification of the Rule. The notification of new rules in middle of the year raises apprehensions for slump sale/exchange deals which were publicly announced before 24 May 2021 and/or were pending for regulatory approval, but are consummated after 24 May 2021.

There are possibilities of actual transaction values being lower than Rule 11UAE value due to diverse commercial factors. The pricing of the deals for acquisition of business are not linked to book value of individual assets & liabilities and/or stamp duty value of immovable property forming part of the undertaking. In case of slump sale, the entire undertaking is valued as a going concern and not individual assets & liabilities. Due to differences in perception of future profitability and/or commercial exigencies of seller, the actual transaction value could be lower than normative Rule 11UAE value.

Stamp duty value is also not always a fair indicator of true commercial value due to individual circumstances of the property like leasehold rights, encroachments, pending litigation on title of the property, poor access/infrastructure, etc. In some cases, the stamp duty value is unrealistically high than true commercial value prevailing in the area. In fact, it is clarified by Explanation 2 to s.2(42C) that determination of value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities.

Since the deals were struck before 24 May 2021 without any prior knowledge on methodology to be adopted by CBDT for computing FMV of undertaking, the parties could not have visualized notional capital gains arising due to shortfall between Rule 11UAE value and actual transaction value. Rule 11UAE, therefore, has retroactive impact on such deals which were publicly announced prior to 24 May 2021 and/or were pending for regulatory approval. The change in seller's tax liability due to application of Rule 11UAE which was not in picture when the commercial deal was signed and announced will disturb the rights and obligations of the parties. The seller gets exposed to higher income tax liability than what was originally contemplated. Consequently, being a business transfer, the buyer also gets exposed to risk of higher tax liability as a successor u/s. 170.

Stable and certain tax legislation is one of the prerequisites for development of business in the country. In fact, the Taxpayer's Charter declared u/s. 119A lists down providing complete and accurate information and timely decisions as duties of the Income Tax Department and taxpayer to be informed of his compliance obligations under tax law and seek help of department, if needed, as expectation from tax payer. Making tax rules which have retrospective effect on concluded business deals is in clear conflict with these rights and obligations of taxpayers.

The erstwhile Finance Minister of current Government has in past given commitment on the floor of the parliament that amendments in the income tax law will not be done with retrospective effect to the prejudice of the taxpayers. The amendment to Section 50B(2) was inserted in the Finance Bill 2021 at last moment without discussion and with retrospective effect. Numerous slump sale transactions are carried out during FY 2020-21 and are pending completion owing to approval or otherwise. All these transactions were entered into by the parties and deals were priced based on tax law prevailing prior to unexpected amendment to s.50B(2). Changes in section 50B(2) and Rule 11UAE has adversely impacted these genuine transactions.

It may be recollected that similar situation arose in the past when buyback distribution tax u/s. 115QA was extended to listed shares by Finance (No.2) Act 2019 w.e.f 5 July 2019. The amendment had a retroactive impact on buybacks which were publicly announced by listed companies prior to 5 July 2019 but consummated after that date. In the wake of industry representations, the Taxation Laws (Amendment) Act 2019 inserted a proviso to s.115QA(1) to clarify that the buyback distribution tax shall not apply to shares of listed companies in respect of which public announcement has been made on or before 5 July 2019 in accordance with SEBI regulations. It is submitted that similar relief is warranted in context of Rule 11UAE.

Another alternative is to provide option to the taxpayer to be governed by old law as prevailing prior to Rule 11UAE or by Rule 11UAE. It may be recollected that similar option was provided to individual salaried taxpayers in 2001 when new perquisite valuation rules were notified by amending Rule 3 in September 2001 with retrospective effect from 1 April 2001. The proviso to erstwhile Rule 3(9) gave option to the employees to compute the value of all perquisites made available to him or any members of his household for the period from 1 April 2001 to 30 September 2001 in accordance with the Rules as they stood prior to the amendment.

Yet another option is to provide that actual slump sale value declared by taxpayer shall not be disturbed unless the AO takes prior approval of High Powered Committee constituted by CBDT. It may be recollected that such Committee was constituted in the past vide CBDT Order No.149/141/2014-TPL dated 28th August, 2014 in context of retrospective amendment for indirect transfer to provide that no fresh cases shall be taken up to tax past indirect transfers without seeking prior approval of the Committee which shall give directions after giving proper opportunity to the taxpayer.

Representation

On lines of proviso to s.115QA(1), it may be clarified that Rule 11UAE shall not apply to slump sale which was publicly announced on or before 24 May 2021 and/or were pending for regulatory approval as on that date. Alternatively, option may be provided to such taxpayers to get covered by Rule 11UAE or be governed by old law. As another

alternative measure to provide relief from retrospective taxation, it may be provided that actual slump sale value declared by taxpayer shall not be disturbed unless the AO takes prior approval of High Powered Committee constituted by CBDT

3. Issue – Opportunity to taxpayer to rebut normative FMV as per Rule 11UAE

As stated earlier, there could be bonafide situations where the actual transaction value is lower than Rule 11UAE value. The book values of assets & liabilities are not necessarily reflective of true commercial value. The buyer may not pay higher price due to contingent liabilities not reflected in the books or any other commercial factor. The stamp duty value is also not necessarily indicative of fair value.

It is precisely for the above reason that all anti-abuse provisions like s.56(2)(x), s.50C, s.43CA, s.50CA, s.56(2)(viib) etc have a 'safety valve' where the taxpayer is given opportunity to rebut the normative value. In s.56(2)(x), s.50C and s.43CA, the value of the property can be adjudicated by the DVO on dispute raised by the taxpayer and if value adjudicated by DVO is less than stamp duty value, such lower value is reckoned for the purposes of application of those provisions. In s.56(2)(viib), the taxpayer company is given opportunity to justify higher premium on issue of shares to resident at value higher than Rule 11UA value to the satisfaction of the AO based on the value of its assets, including intangible assets being goodwill, know-how, patents, copyrights, trademarks, licenses, franchises, etc. The CBDT has taken power u/s. 56(2)(x) and s.50CA to notify bonafide situations in which such anti-abuse provisions will not apply.

It may also be recollected that in the case of K. P. Varghese v ITO (1981)(131 ITR 597), the Supreme Court read down erstwhile s.52(2) (akin to current s.50C) to hold that it would apply only where the consideration for the transfer is understated or, in other words, the assessee has actually received a larger consideration for the transfer than what is declared in the instrument of transfer and it would have no application in case of a bona fide transaction where the full value of the consideration for the transfer is correctly declared by the assessee. The SC held that merely because fair value of the property is higher than consideration received by the assessee, it is not sufficient to levy tax on the shortfall.

However, neither s.50B(2) nor Rule 11UAE provides such 'safety valve' or opportunity to the taxpayer to rebut the normative FMV as determined under Rule 11UAE. This can give rise to unwarranted litigation in bonafide cases and levy of tax on notional income.

Representation

Rule 11UAE may be amended to provide opportunity to the taxpayer to rebut the normative FMV as determined under Rule 11UAE and justify that actual transaction value is the FMV. The following measures may be considered in this regard without prejudice to one another :-

a. Where taxpayer disputes the stamp duty value of the property, the mechanism as currently provided in s.50C(2) to refer the valuation to DVO may be provided.

b. Where the difference between FMV as per Rule 11UAE and actual transaction value is not more than 10%, the shortfall may be ignored on lines of tolerance limit/safe harbour provided in s.50C.

c. Taxpayer may be permitted to furnish valuation report by Category I merchant banker or practicing Chartered Accountant as per internationally accepted valuation principles in support of FMV being lower than Rule 11UAE value.

d. Transactions between Indian listed companies and/or transactions which are approved by National Company Law Tribunal (NCLT) after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner (akin to s.79(2)(c)) may be exempted from higher valuation under Rule 11UAE.