2nd Intensive Workshop on Foreign Exchange Management Act, 1999 (FEMA)

Session XV
Pricing Guidelines, Norms (Inward/Outward)/Valuation

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Agenda

Pricing Guidelines, Norms (Inward / Outward) / Valuation

- Issue of Equity Instruments
- Transfer of Equity Instruments
- Swap of Equity Instruments
- Subscription to MOA
- Partly Paid Shares
- Share Warrants
- Investment in LLP
- Transfer of Capital Contribution / Profit share of an LLP
- Non-Applicability of Pricing Guidelines
- Convertible Instruments & Securities
- Redeemable Instruments & Securities

Pricing Guidelines

PART A

The pricing / valuation guidelines are governed by the Foreign Exchange Management Act, 1999, FEM Regulations, 2017 and RBI Notification & regulations issued and updated on time to time.

The crux of the these Guidelines is summarized hereunder:

1. Issue by an Indian company or transferred from a R-to-NR : Price should not be **less than**
    - **Listed Company** – The price worked out in accordance with the relevant **SEBI guidelines**
    - **Unlisted Company** – The fair value worked out as per any internationally accepted pricing methodology for valuation on an **arm's length basis**, duly certified by a Chartered Accountant or a SEBI registered Merchant Banker.

2. Transfer from a NR-to-R : Price should not be **more than**
    - **Listed Company** – The price worked out in accordance with the relevant **SEBI guidelines**
    - **Unlisted Company** – The fair value worked out as per any internationally accepted pricing methodology for valuation on an arm's length basis, duly certified by a Chartered Accountant or a SEBI registered Merchant Banker.

Valuations Guidelines for listed Company

Governed by SEBI (ICDR) regulations, 2009

Unless otherwise provided, these regulations shall apply to the following:

A public issue	A rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more	A preferential issue	An issue of bonus shares by a listed issuer	A qualified institutions placement by a listed issuer	An issue of Indian Depository Receipts.

Pricing of Equity Shares : Frequently Traded Shares

If shares listed for a period of 90 trading days or more shares shall be allotted at a price not less than **higher of the following**:

- The 90 trading days volume weighted average price of the related equity shares on the recognised stock exchange preceding the relevant date;
- The 10 trading days volume weighted average prices of the related equity shares on a recognised stock exchange preceding the relevant date.

Pricing of equity shares : Frequently traded shares

If shares listed on a stock exchange for a period of less than 90 trading days, the equity shares shall be allotted at a price not less than the **higher of the following**:

- The price at which shares were issued by the in its IPO or the value per share as per scheme under sections 230 to 234 of the Co. Act, 2013, pursuant to which the equity shares of the issuer were listed, as the case may be
- The average of the volume weighted average prices of the related equity shares quoted on the recognised stock exchange during the period, shares have been listed preceding the relevant date
- The average of the 10 trading days, volume weighted average prices of the related shares quoted on a stock exchange during the 2 weeks preceding the relevant date

Pricing of equity shares – Infrequently traded shares.

- Where the shares are not frequently traded, the price determined by the issuer shall take into account valuation parameters including book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies:

- Provided that the issuer shall submit a certificate stating that the issuer is in compliance of this regulation, obtained from an independent registered valuer to the stock exchange where the equity shares of the issuer are listed.

Valuations Guidelines for Unlisted Company: Under different scenarios

Transferred by a person resident outside India to a person resident in India shall not exceed:

The valuation of capital instruments done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by

- A Chartered Accountant or
- A Securities and Exchange Board of India registered Merchant Banker

Valuations Guidelines for Unlisted Company: Under different scenarios Contd…

❑ Share Warrants

- In the case of public offer, the price of shares to be issued is not less than the price at which shares are issued to residents; and
- In case of share warrants, their pricing and the price/ conversion formula shall be determined upfront.

❑ Right Issue

- The offer on right basis to the persons resident outside India should have been at a price which is not lower than that at which the offer is made to resident shareholders.

❑ Preferential Allotment

- A new category of preferential allotment has been created. Price of shares issued on preferential allotment should not be lower than the price as applicable to transfer of shares from residents to non-residents.

Valuations Guidelines for Unlisted Company: Under different scenarios Contd…

- Swap of equity instrument
    - Issue of shares to a non-resident against shares swap i.e., in lieu for the consideration which has to be paid for shares acquired in the overseas company, can be done with the approval of FIPB.
    - In case of swap capital instrument, the valuation will be made by a Merchant Banker Registered with the SEBI or an Investment banker outside India registered with the appropriate authority in the host country.
- Memorandum of Association – **Subscription**
    - where non-residents (including NRIs) are making investments in an Indian company in compliance with the provisions of the Companies Act, 2013, by way of subscription to its Memorandum of Association, such investments may be made at face value subject to their eligibility to invest under the FDI scheme.

Foreign Direct Investment in Limited Liability Partnership (LLP)

- Limited liability partnership shall be eligible to accept Foreign Direct Investment under government approval route, subject to the few conditions.
- FDI in an LLP either by way of capital contribution or by way of acquisition / transfer of ‘profit shares’, would have to be more than or equal to the fair price as worked out with any valuation norm which is internationally accepted as per market practice and a valuation certificate to that effect shall be issued by a chartered accountant or by a practicing cost accountant or by an approved valuer from the panel maintained by the central government.
- Transfer of capital contribution / profit share of an LLP
  - In case of transfer of capital contribution/profit share from a resident to a nonresident, the transfer shall be for a consideration equal to or more than the fair price of capital contribution/profit share of an LLP. further, in case of transfer of capital contribution/profit share from a non-resident to a resident, the transfer shall be for a consideration which is less than or equal to the fair price of the capital contribution/profit share of an LLP.

❑ Convertible Instruments & Securities

- The pricing of convertible instruments should be determined upfront at the time of issue of the instruments.
- The price for the convertible instruments can also be a determined based on the conversion formula which has to be fixed upfront, however the price at the time of conversion should not be less than the fair value worked out, at the time of issuance of these instruments, in accordance with the extant FEMA regulations.

❑ Issue of Non-convertible / redeemable bonus preference shares or debentures

- To rationalize and simplify the procedures, an Indian company may issue nonconvertible/ redeemable instruments to NR shareholders, including the depositories that act as trustees for the ADR/GDR holders, by way of distribution as bonus from its general reserves under a Scheme of Arrangement approved by a Court in India under the provisions of the Companies Act, as applicable, subject to no-objection from the Income Tax Authorities.
- The above general permission to Indian companies is only for issue of nonconvertible/ redeemable instruments to NR shareholders by way of distribution as bonus from the general reserves.

❑ Non – Applicability Of Pricing Guidelines Under FEMA Regulations

- The pricing guidelines under FEMA Regulations are not applicable for any investment in capital instruments by non-resident in India on the non-repatriation basis.
- Share transfer via sale in accordance with SEBI Regulations;

FDI vs ODI

FDI

- FDI occurs when a non-resident invests in the shares of a resident company.
- FDI price stands as the Minimum Price
- It can also help to improve the effectiveness of companies and economies. FDI has many benefits for both countries involved. However, it can also be risky and difficult to control, especially when trading partners do not follow similar rules.

ODI

- ODI involves a domestic company expanding its operations abroad. This is different from Foreign Direct Investment (FDI), as the company invest in its own firm to create subsidiary firm in foreign countries for expansion.
- ODI price stands as the Maximum Price
- In ODI company investing typically brings knowledge and skills that are not available domestically.
- ODI has some limitations. One is that there is always the potential for political instability or other geopolitical issues.

Valuation Under FEMA

PART B

What is a Valuation?

- Valuation is the process of accessing the actual/ fair market price of the shares/ debentures or the capital instrument. Valuation is carried out as the prices of shares/ debentures keep fluctuating. Valuation of the instrument is carried out for the following:
  - To understand how the valuation price is calculated.
  - Procedure-related to the valuation of an instrument.
  - To understand the international accepted method of valuation.
  - To comply with the laws related to Foreign Exchange.
- Valuation is required when a capital instrument is transferred. The transfer of capital instrument is regulated by the laws related to FEMA. The transfer by way of sale shall be done through the principle that is adopted as arm’s length price. This would be accepted according to an international methodology.

Who Regulates Business Valuation / Share Valuation Under FEMA

- Reserve Bank of India
- Foreign Exchange Management Act, 1999
- Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 (FEMA 20)
- Companies Act 2013

Who can conduct the valuation of Equity instrument under different Acts?

Valuation Report by	Under Companies Act, 2013	Under FEMA, 1999	Under Income Tax Act, 1961
Chartered Accountant	✗	✔	NAV Method only
Registered Valuer & Chartered Accountant	✔	✔	NAV Method only
Merchant Banker	✗	✔	✔

Who can conduct the valuation of Convertible instrument and other security under different Acts?

Valuation Report by	Under Companies Act, 2013	Under FEMA, 1999	Under Income Tax Act, 1961
Chartered Accountant	✗	✓	✓
Registered Valuer & Chartered Accountant	✓	✓	✓
Merchant Banker	✗	✓	✓

Internationally Accepted Pricing Methodology for Valuation

Asset Based Approach

- Net Assets Value (NAV) Method.
- Price to Book (P/B) Multiple Method.

Earning Based Approach

- Price Earnings Capitalisation Value (PECV) Method.
- Enterprise Value(EV)/ EBITDA Multiple - (CCM) Method.
- Discounted Cash Flow (DCF) Method.

Market Based Approach

- Market Price Method.

Other factors

- Control premium,
- Minority discount
- Judicial pronouncements

Valuation of Shares and Securities in case of fresh issuance and transfer of shares under Income Tax Act, 1961

- ❖ Valuation of shares and securities u/s 56(2)(viib) (Applicable to company issuing shares and securities)
  - Where a private company receives, any consideration for issue of shares that exceeds the FV of such shares, the aggregate consideration received for such shares as exceeds the FMV of the shares shall be chargeable to income tax under income from other sources.
  - FMV as on the valuation date for issuance of shares shall be the value as may be determined in accordance with Rule 11UA(2) of Income Tax Rules, 1962; or as may be substantiated by the company to the satisfaction of the AO, whichever is higher.
- ❖ Valuation of shares and securities u/s 56(2)(x)(Applicable to recipient of shares and securities)
  - As per section 56(2)(x)(c) where a person receives any property other than immovable property without consideration or for a consideration less than fair market value of such property by an amount exceeding Rs. 50,000, the difference between fair market value of property and consideration paid, shall be taxable in hands of recipient as income from other source.

Valuation of quoted shares and securities

Type of security	Quoted Shares : Carried through Recognized Stock Exchange	Quoted Shares : Carried out other than through Recognized Stock Exchange	Quoted Shares : Carried out other than through Recognized Stock Exchange
Transaction	NA	If valuation date is trading day	If valuation date is non-trading day
Applicable Rule	Rule 11UA(1)(c)(a)(i)	Rule 11UA(1)(c)(a)(ii)(a)	Rule 11UA(1)(c)(a)(ii)(b)
Fair Market Value	Transaction Value as recorded in stock exchange	Lowest price quoted on any recognised stock exchange on such valuation date	Lowest price quoted on any recognised stock exchange on trading day immediately preceding from valuation date
Prescribed Valuer	NA	NA	NA

Valuation of unquoted shares and securities

Type of security	Unquoted equity shares	Unquoted equity shares	Unquoted securities other than equity shares
Transaction	In case of fresh issuance of shares	Any person receiving the share or security	Applicable for all cases
Applicable Rule	Section 56 (2) (viib) read with Rule 11UA(2)	Section 56 (2) (x) read with Rule 11UA(1)(c)(b)	Section 56 (2) (viib) and (x) read with rule 11UA(1)(c)(c)
Fair Market Value	Discounted Cash Flow method (DCF) or book value method at the option of assesse	Book Value method	Not prescribed
Prescribed Valuer	Merchant Banker for DCF. For book value either of MB or CA	Either of MB or CA	Either of MB or CA

Angel Tax and Exemption

What is Angel Tax?

- The provision known as the 'angel tax' was initially introduced in 2012 to discourage the generation and utilization of unaccounted money through investments in closely held companies.
- It is the tax that must be paid on the funds raised by unlisted companies through the issuance of shares in off-market transactions, if they exceed the fair market value of the company.
- Fair market value (FMV) is the price of an asset when buyer and seller have reasonable knowledge of it and are willing to trade without pressure.

Angel Tax and Exemption

What are the Changes Brought by CBDT Related to Angel Tax?

- Expansion to Include Foreign Investors:
- Under the Finance Act, 2023, a relevant section of the Income-tax Act was amended to include foreign investors in the ambit of the angel tax provision.
- Currently, if a start-up company receives equity investment from a resident that exceeds the face value of the shares, it is considered as income for the start-up and subject to income tax under the category of 'Income from other Sources' for that financial year.
- The recent amendment extends this rule to include foreign investors as well. This meant that start-ups raising funds from foreign investors would also be subject to taxation.
- However, start-ups recognized by the Department for Promotion of Industry and Internal Trade (DPIIT) are excluded from this provision.

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What are the Changes Brought by CBDT Related to Angel Tax?

- **Exemptions for Government and Recognized Investors:**
- The CBDT has outlined several categories of investors that will be exempted from the angel tax. These include:
  - Government and government-related investors, such as central banks, sovereign wealth funds, and international or multilateral organisations, or where ownership of the government is 75% or more.
  - Banks or entities involved in the insurance business.
  - Entities registered with SEBI as Category I Foreign Portfolio Investors (FPI), endowment funds, and pension funds.
  - Broad-based pooled investment vehicles or funds where the number of investors is more than 50 and such fund is not a hedge fund too are exempt.
    - Hedge funds pool money from investors and invest in securities or other types of investments with the goal of getting positive returns.
    - As the name suggests, the fund tries to hedge risks to investor's capital against market volatility by employing alternative investment approaches.

Angel Tax and Exemption

- ❑**Proposed Changes in Valuation Rules:**
- ❑If a non-resident entity notified by the central government provides consideration to a company for issuing shares, the fair market value (FMV) of the equity shares may be determined based on the price corresponding to that consideration.
- ❑However, this consideration should not exceed the aggregate consideration received from the notified entity within 90 days of the share issuance.

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THANK YOU

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