Valuation of securities or financial assets

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Scope for a Practicing CA

- ✓ Under FEMA only practicing CA/CMA or Merchant Banker can do valuation.
- ✓ Under Income Tax Act practicing CA can do valuation under some of the rules.
- ✓ Advising the right course of action to client under Companies Act, FEMA & Income Tax Act.
- ✓ Questioning value of investments as an auditor specially under IND AS.
- ✓ Aspiring to be a registered valuer

- Companies Act, 2013
- Insolvency and Bankruptcy Code, 2016
- Income Tax Act, 1961
- Foreign Exchange Management Act, 1999
- Security and Exchange Board of India Guidelines

Mandatory under Companies Act, 2013

- ✓ 54(1)(d) Sweat equity shares and IPR.
- ✓ 62(1)(c) preferential basis or for non-cash consideration (value both share and consideration).
- ✓ 67(3)(b) buy back of shares
- ✓ 192(2) non cash transfer of assets to or by directors
- ✓ 230 & 232 compromise or arrangement or Merger
- ✓ 234 cross border merger (Indian into foreign or vice versa)
- ✓ 236 purchase of minority share holding
- ✓ 281 Winding up of the company

Issue of Sweat Equity shares

Section 54(1)(d) read with Share Capital & Debenture Rules 8 :

If a company is planning to issue sweat equity shares to its Directors or employees then two valuations are required:

a) Valuation of "Intellectual Property Right" or "Value Addition" and

b) Valuation of equity shares of the company

Note: Besides valuation by merchant banker is also required under Income Tax Act.

Contd…

- the expression ‘**Value additions**’ means actual or anticipated economic benefits derived or to be derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of an employee.

Mandatory under Companies Act, 2013

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Preferential Allotment of shares

Section 62(1)(c) read with Share Capital & Debenture Rule 13

a) Valuation is compulsory.
b) In case of non cash consideration valuation of consideration is also required.
c) Not required in case of right issue.
   a) For issue of declined rights is it required
   b) In case of renunciation of right it is recommendatory
d) Valuation is required even if shares are issued to existing shareholders disproportionately.
e) Valuation is required in case of Employee Stock Options (MB valuation is required for unlisted co. at exercise date)

Preferential Allotment of shares

Section 62(1)(c) read with Share Capital & Debenture Rule 13

f) Valuation is required even in case of a listed company if its shares are not frequently traded.

Here infrequently traded means number of shared traded in last 12 calendar months are less than 10% of total number of shares of that class.

If number of shares changes then take weighted average.

SE means the SE where highest trading volume in respect of the equity shares of the issuer has been recorded during the preceding twenty six weeks prior to the relevant date.

Preferential Allotment of shares

Section 62(1)(c) read with Share Capital & Debenture Rule 13

g) In case of listed company with frequently traded shares issue price should be at-least:

   i. Average of weekly high and low of VWAP of last 26 weeks
   ii. Average of weekly high and low of VWAP of last 2 weeks

Here Valuation need not to be certified by RV but as a good governance practice companies take certificate from CA.

Preferential Allotment of shares

Section 62(1)(c) read with Share Capital & Debenture Rule 13

h) Besides equity shares, valuation is required even if the company is issuing convertible securities like:
   i) Compulsorily Convertible Preference Shares
   ii) Optionally Convertible Preference Shares
   iii) Compulsorily Convertible Debentures
   iv) Optionally Convertible Debentures (deposit)

Valuation may be done either at the time of issue of security or at the time of conversion.

Preferred Shares	Seniority	# of Shares Outstanding	OIP/ Strike Price	Conversion Ratio	Conversion Price	LP Per share
Class A CCCPS	1	78,791	26,958	1.000	26,958	26,958
Class B CCCPS	1	16,396	97,713	1.000	97,713	97,713
Class C CCCPS	1	13,664	113,739	1.000	113,739	113,739
Class D CCCPS	1	28,460	136,396	1.125	121,241	136,396
Class E CCCPS	1	729,192,849	-	0.000000	-	-
Class F CCCPS	1	190,653,540	-	0.000000	-	-
Class G CCCPS	1	10,885	118,881	1.000	118,881	118,881
Class H CCCPS	1	83,425	116,267	1.000	116,267	116,267
Class I CCCPS	1	103,500	218,791	1.000	218,791	218,791

Options		
Option Outstanding	58,056	5,564
Option Pool	13,860	

Common	
Common	295,928

Total	**920,549,354**

Mandatory under Companies Act, 2013

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- ✓ 67(3)(b) buy back of shares
- ✓ Section 73 & Deposit rules
- ✓ 192(2) non cash transfer of assets to or by directors
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- ✓ 281 Winding up of the company

Purchase of shares by Trust for benefit of employees

Section 67(3)(b) read with Share Capital & Debenture Rules 16

- For offering share based payment to employees some companies do form a trust.
- If the trust is buying share of that unlisted company then valuation of shares is to be done by a registered valuer.

Mandatory under Companies Act, 2013

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Secured Debentures are not deposit

Acceptance of deposit Rules 2

- Debentures are not treated as deposit if secured by a first charge on assets referred to in schedule III except Intangible assets.
- the amount of such bonds or debentures shall not exceed the market value of such assets as assessed by a registered valuer

Mandatory under Companies Act, 2013

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Non cash transfer of assets to or by directors

Section 192(2)

a) Valuation of asset acquired from director or acquired by director from company must be done the registered valuer.
b) If the company is issuing its shares to director for acquisition of asset from director then it will automatically attract section 62(1)(c) also for preferential allotment of shares.
c) Valuation should be done by relevant valuer like SFA, LB or PM.

Mandatory under Companies Act, 2013

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Compromise or arrangement or Merger

Section 230 and Section 232

a) In case of merger of two or more unlisted companies Valuation of individual companies on standalone basis as well as calculation of exchange ratio is required.

b) In case of compromise or arrangement with creditor or debt restricting valuation of assets of company including intangible assets and goodwill is required.

c) If members holding 75% or more shares in an unlisted company want to acquire remaining shares they can apply to NCLT (amended in Feb 2020). In this case valuation is required. Section 236 is also about squeezing out minority but that is available to 90% majority and is event base.

Cross border merger

Section 234 read with Amalgamation Rule 25A

If a company registered outside India is to be merged with a company registered in India and vice versa then valuation is required.

Winding up of the company

Section 281

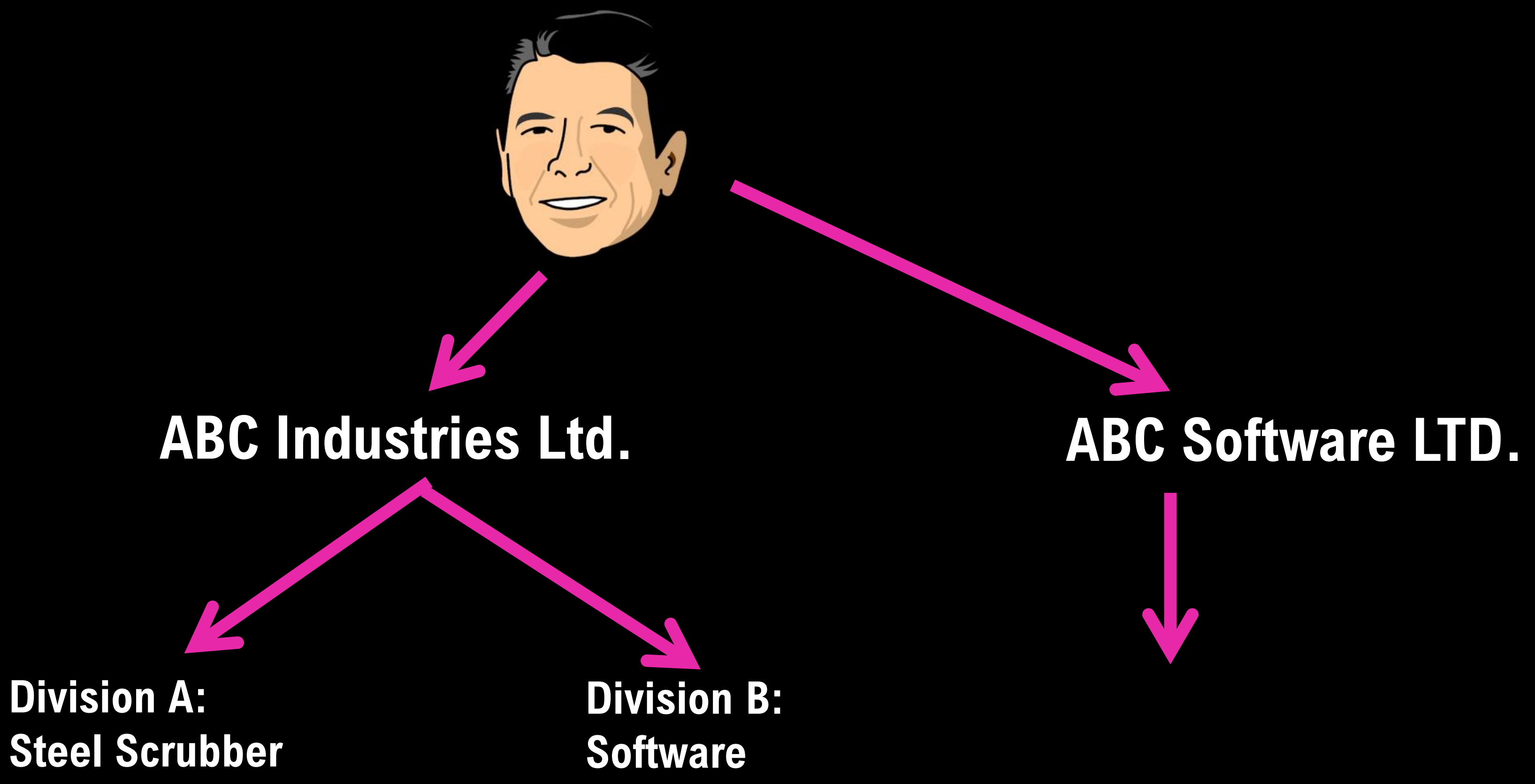
When NCLT appoints a liquidator, he will submit several reports to NCLT. Here Valuation report is to be prepared by Valuer.

But now people prefer to go for liquidation under IBC. In that case also valuation is required.

Recommendatory under Companies Act, 2013

- ✓ 61(1)(b) consolidation of nominal value. For fractional shares
- ✓ 62(1)(a) right issue. Where say some shareholders renounce their right in favour of other shareholders.
- ✓ 62(1)(a) right issue (for governance or documentation)
- ✓ Reduction of share capital u/s 66 (squeeze out minority shareholders simultaneously)
- ✓ Buy back u/s 68 (for governance). For NRI shareholders you need under FEMA.
- ✓ Sec.242(2)(b) tribunal may appoint valuer in case of oppression and mismanagement u/s241.
- ✓ Demerger without change in shareholding pattern.
- ✓ Merger of wholly owned company

Spin-off


ABC Industries Ltd.
ABC Software LTD.
Division A:
Steel Scrubber
Division B:
Software

Valuer should not have a direct or indirect interest at any time during a period of three years prior to his appointment as valuer or three years after.

- Companies Act, 2013
- Insolvency and Bankruptcy Code, 2016
- Income Tax Act, 1961
- Foreign Exchange Management Act, 1999
- Security and Exchange Board of India Guidelines

Securities Valuation under Income Tax Act, 1961

1) Issue of shares by unlisted company [sec 56(2)(viib)]
2) Sell of unquoted shares [sec 50CA]
3) Receive any security [sec 56(2)(x)]
4) Sell of shares of Indian company by foreign entity [9(1)(i)]

Issue of shares by unlisted co.
56 (2) (viib)

Applicability:

When company issues shares at a premium amount received in excess of fair value is income in the hands of company

Exemptions:

1) Shares issued to non residents
2) Venture capital [sec 10(23FB)]
3) Category I & II alternative investment funds
4) Start ups registered with DPIIT

Issue of EQUITY shares by unlisted co. 56 (2) (viib)

Fair Market Value of equity shares [Rule 11UA(2)]:

Book Value Method : $(A - L) \times PV/PE$

A = book value of all assets

L = book value of all liabilities

(audited BS on valuation date or last adopted BS in AGM)

Discounted Cash Flow Method: by Merchant Banker

Issue of Preference shares by unlisted co. 56 (2) (viib)

Fair Market Value of Preference shares [Rule 11UA(1)(c)(c)]:

Assessee may obtain a report from MB or CA

Sell of unquoted shares sec 50CA

If sold below FMV then FMV will be deemed to be consideration.

Fair Market Value of <u>Preference</u> shares [Rule 11UA(1)(c)(c)]:

Assessee may obtain a report from MB or CA

Sell of unquoted shares sec 50CA

Fair Market Value of Equity shares [Rule 11UA(1)(c)(b)]:

A = Book value of all assets

B = FMV of jewelry & art work

C = FMV of shares and securities as per this rule

D = Stamp duty value of immovable properties

L = Book value of liabilities

(Audited BS on valuation date only)

$$Fair\ value\ of\ equity = (A + B + C + D - L) \times \frac{PV}{PE}$$

Receive any security sec 56(2)(x)

If consideration paid is less than FMV, difference amount is taxable

<u>Quoted shares & Securities</u> [Rule 11UA(1)(c)(a)]:

If transacted through exchange : transaction value

Otherwise : lowest price on valuation date or latest date

Unquoted Securities other than equity shares [Rule 11UA(1)(c)(c)]:

Assessee may obtain a report from MB or CA

Receive any security sec 56(2)(x)

Fair Market Value of <u>Equity</u> shares [Rule 11UA(1)(c)(b)]:

A = Book value of all assets
B = FMV of jewelry & art work
C = FMV of shares and securities as per this rule
D = Stamp duty value of immovable properties
L = Book value of liabilities
(BS on valuation date)

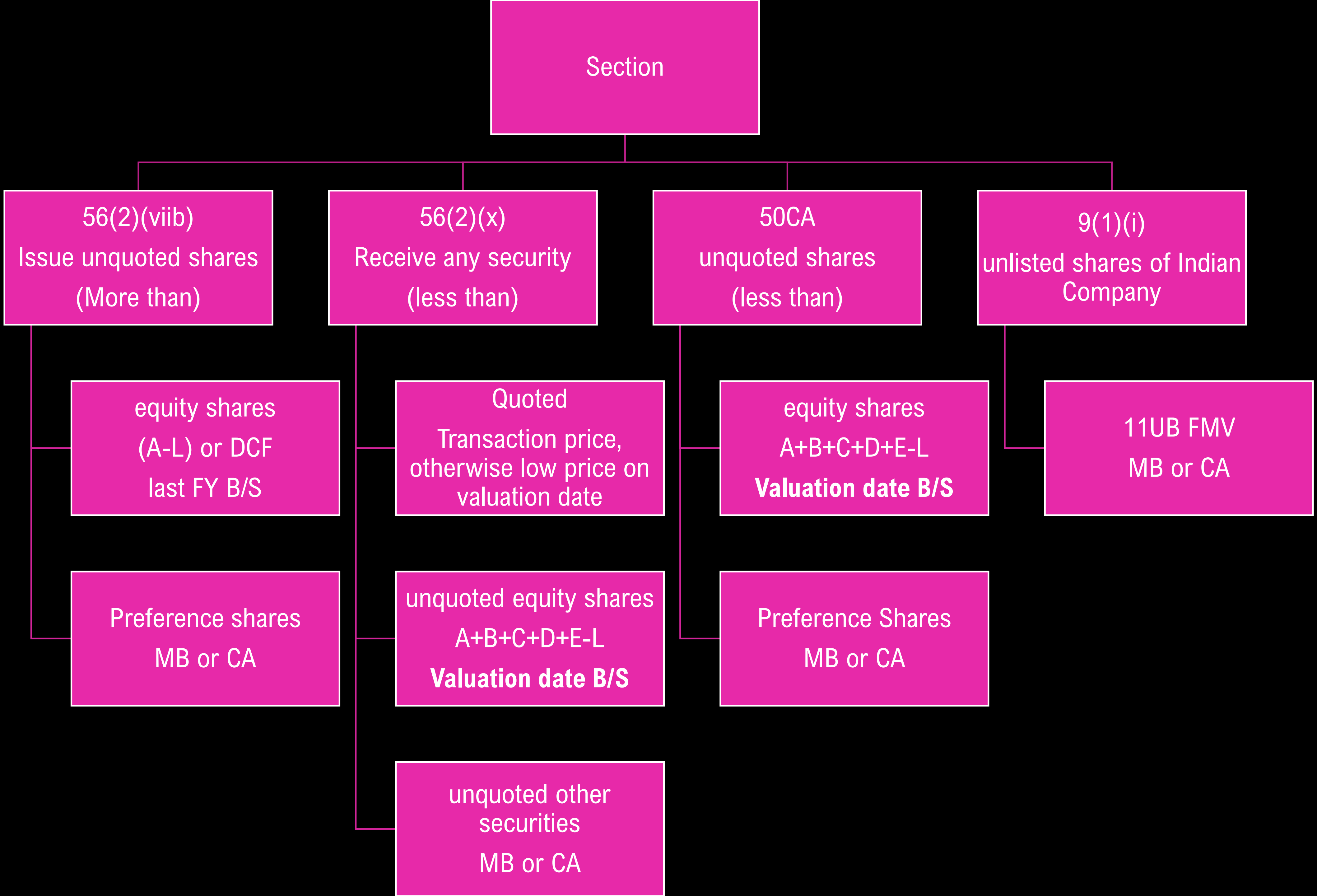
$$Fair\ value\ of\ equity = (A + B + C + D - L) \times \frac{PV}{PE}$$

Sell of shares of Indian company by foreign entity 9 (1) (i)

share of an Indian company listed on a recognized stock exchange on the specified date, the fair market value of the share shall be the observable price of such share on the stock exchange

share of an Indian company not listed on a recognized stock exchange on the specified date, the fair market value of the share shall determined by a merchant banker or an accountant in accordance with any internationally accepted valuation methodology

The fair market value of other securities shall be the price it would fetch if sold in the open market on the specified date as determined by a merchant banker or an accountant


Section
56(2)(viib)
Issue unquoted shares
(More than)
equity shares
(A-L) or DCF
last FY B/S
Preference shares
MB or CA
56(2)(x)
Receive any security
(less than)
Quoted
Transaction price, otherwise low price on valuation date
unquoted equity shares
A+B+C+D+E-L
Valuation date B/S
unquoted other securities
MB or CA
50CA
unquoted shares
(less than)
equity shares
A+B+C+D+E-L
Valuation date B/S
Preference Shares
MB or CA
9(1)(i)
unlisted shares of Indian Company
11UB FMV
MB or CA

Conflict – 1

- If FMV under 56(2)(viib) is Rs.100 and FMV under 56(2)(x) is Rs.180
- If issued at Rs.100 then Rs.80 may become taxable in hands of shareholder !!
- If issued at Rs.180 then Rs.80 will be taxable in hands of company !!

Conflict -2

- If valuation given by registered valuer under companies act is Rs.500 per share and valuation given by Merchant Banker under Income Tax Act is Rs.400 per share.
- Under companies act shares can't be issued below Rs.500
- Under Income Tax act if issued at Rs.500 then Rs.100 will be taxable in hands of company.

Thanks

Feel Free to Contact me
For any doubt on valuation:

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