Appendix

A. Key observations and recommendations on draft Rule 11UA

<table>
<tr><th>Extract of draft Rule 11UA</th><th>Key observations with respect to draft Rule 11UA</th><th>Recommendation</th></tr>
<tr><td>Valuation methodology
• Rule 11UA currently prescribes two valuation methods with respect to valuation of equity shares namely, Discounted Free Cash Flow (DCF) and adjusted Net Asset Value (NAV) method for resident investors.
• Proposed Rule 11UA(2)(d) introduced following five (5) valuation methodology <u>for equity share issuance to non-resident investors</u>, in addition to the DCF and adjusted NAV methods of valuation:
(i) Comparable Company Multiple Method;
(ii) Probability Weighted Expected Return Method;
(iii) Option Pricing Method;
(iv) Milestone Analysis Method;
(v) Replacement Cost Methods.</td><td><u>Restriction on methods of Valuation prescribed</u>
• The pricing guidelines notified under FEMA provisions provide flexibility to non-resident to invest as per any internationally accepted valuation methodology. The reason for restricting the Angel tax provision to certain prescribed methodologies as mentioned under the draft Rule 11UA as against any internationally accepted valuation methodologies as provided under FEMA pricing guidelines is unclear.
<u>Restriction on usage of five new methodology with respect to equity share issuance to non-resident investors</u>
• Further, the rationale of limiting the five new methods of valuation (in addition to existing NAV and DCF) to equity investments made by non-resident investors is unclear. This could create practical challenge and discrimination for resident investors.
• To illustrate, in the same round of funding by resident and non-residents at same price of say- Rs. 200 per share arrived by using comparable company multiple method, where DCF value is say, Rs. 150 per share, while there will be no trigger of angel tax for investment by non-resident, the investment by residents will face angel tax valuation dispute for the differential of Rs. 50.
• It is true that the investment by resident investor will not face angel tax if it fits within the price matching facility under proposed Rule 11UA(2)(c)/ Rule 11UA(2)(e) or safe harbour of 10% under Rule 11UA(4). However, these reliefs may not be sufficient to protect all bonafide investments by residents. For instance, there may be no investment by excluded non-resident investor in the same round or the value differential between DCF and five new methods may be higher than 10%.</td><td>• Amended Rule 11UA should allow the flexibility to use any internationally accepted valuation methodology for the purpose of determining fair market valuation (FMV) of Indian company to avoid the need for potentially obtaining multiple valuation reports under different regulations.
• Further, the five new methodologies to be prescribed under amended Rule 11UA should be equally available for investments by resident investors as well.</td></tr>
</table>

Extract of draft Rule 11UA	Key observations with respect to draft Rule 11UA	Recommendation
Price matching *Rule 11UA(2)(c) – "Where any consideration is received by a venture capital undertaking (VCU) for issue of shares from a Venture Capital Fund (VCF) or Venture Capital Company (VCC) or a Specified Fund, the price of the equity shares corresponding to such consideration may at the option of undertaking, be taken as the FMV of the equity shares to the extent the consideration from such FMV does not exceed the aggregate consideration that is received from VCF, VCC and Specified Fund"* *Provided that the consideration has been received by the undertaking from VCF/VCC or Specified Fund within a period of ninety days of the date of issue of shares which are the subject matter of valuation.* Illustration: If a venture capital undertaking receives a consideration of Rs 50,000 from a venture capital company for issue of 100 shares at the rate of Rs. 500 per share, then such an undertaking can issue 100 shares at this rate to any other investor within a period of 90 days of the receipt of consideration from venture capital company." *Rule 11UA(2)(e) – "Where any consideration is received by a company for entities notified under clause (ii) of the first proviso to clause (viib) of section 56, the price of the equity shares corresponding to such consideration may at the option of such company, be taken as the FMV of the equity shares to the extent the consideration from such FMV does not exceed*	**<u>Window period of price matching facility to investment prior and post investment by excluded NR investor</u>** • There is contradiction in language of proposed Rule 11UA(2)(c) and the illustration provided therein. • As per literal language of the draft Rule 11UA(2)(c) and Rule 11UA(2)(e), the investment by VCF/VCC or Specified Fund or Notified entity should be within a period of 90 days of the date of issue of shares which are subject matter of valuation. But the illustration states that the shares which are subject matter of valuation should be issued within a period of 90 days of receipt of consideration received from VCF/VCC, Specified Fund or Notified entity. • This creates confusion whether the share investment which is subject matter of valuation should precede or succeed the investment by excluded non-resident. • Ideally, the window period should cover both prior and post the investment by excluded entities since the sequencing of investments or rounds of funding may not necessarily be within the control of the company. **<u>Quantum of permissible investment by resident and non-resident investors in price matching facility</u>** • As per draft Rule 11UA(2)(c) and Rule 11UA(2)(e), to avail relief under price matching facility, the consideration received from other investors at such FMV should not exceed aggregate consideration received from notified/excluded entity. • This appears to be an anti-abuse measure. For instance, a very small token investment by Sovereign Wealth Fund (say, 1%) should be not used to claim exemption in respect of substantial investments by other resident or non-resident investors.	• The language of draft Rule 11UA(2)(c) and Rule 11UA(2)(e) should be amended to allow usage of price matching facility both 90 days prior and 90 days after the investment by VCF/VCU Specified Fund or Notified entity. • Rule 11UA(2)(c) and Rule 11UA(2)(e) should be amended to allow price matching upto 200% of investment made by VCF/VCC, Specified Fund or Notified entity instead of 100% as proposed under the draft Rules.

Extract of draft Rule 11UA	Key observations with respect to draft Rule 11UA	Recommendation
the aggregate consideration that is received from notified entity" *Provided that the consideration has been received by the company from entities notified under clause (ii) of the first proviso to clause (viib) of section 56 ("Notified entity") within a period of ninety days of the date of issue of shares which are the subject matter of valuation.*	• However, it is submitted that the quantum limit is very low. It should be increased to at least twice (200%) of quantum of investment by notified non-resident investor. This will increase ability of the Indian company to raise more funding from resident and non-resident investors without the hassle of angel tax. This will have positive impact on growth and jobs in the Indian economy.	
Valuation Report Rule 11(3) - "*Where the valuation report by merchant banker for the purpose of sub-rule (2) is not more than ninety days prior to the date of issue of shares which are the subject matter of valuation, such date may, at the option of the assessee, be deemed to be the valuation date.*	• As per FEMA pricing guidelines, valuation report of an Indian company for inbound investment is valid for a period of 180 days. Further, Rule 3(8)(iii) for the purpose of perquisite taxation also allows the usage of valuation report for a period of 180 days. • Therefore, the validity period of 90 days for valuation report is not consistent with the time limits as specified under FEMA pricing guidelines and/ or under other provisions of the Income-tax Act.	• Accordingly, in order to align the provisions of FEMA and other provisions of Income-tax Act, a period of 180 days should be provided instead of 90 days.
Safe Harbour "*Rule 11UA(4) - Where the issue price of the shares exceeds the value of shares determined in accordance with clause (a) or (b) of sub-rule (2), for consideration received from resident by an amount not exceeding ten percent of the valuation price, the issue price shall be deemed to be the FMV of such shares"*	• The press release indicates that 10% tolerance limit is provided to cover variation in price on account of forex fluctuations, bidding processes, variation in other economic indicators which may impact valuation. • However, the tolerance limit of 10% may not be sufficient to address all these changes.	• It is suggested to increase the tolerance limit to 25% which may be considered as sufficient for meeting price gaps owing to factors such as forex fluctuations, price negotiations, bidding processes and other economic indicator.

Extract of draft Rule 11UA	Key observations with respect to draft Rule 11UA	Recommendation
Preference shares There is no amendment proposed to Rule 11UA(1)(c)(c) which prescribes the valuation of preference shares at price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of which such valuation.	• Since there is no fixed valuation rule prescribed for preference shares, it is understood that there is flexibility for the merchant banker to adopt any internationally recognised valuation methodology or combination thereof to value preference shares including 5 new methods as proposed to be prescribed for equity shares. • However, it is not clear why preference shares are not proposed to be covered under following reliefs as proposed to be provided for valuation of equity shares :- 1. Price matching facility under proposed Rule 11UA(2)(c)/(e); 2. Flexibility of validity of valuation by Category I merchant banker upto 90 days as proposed under Rule 11UA(3); 3. Safe harbour of 10% as proposed under Rule 11UA(4). It is submitted that the challenges faced by resident and non-resident investors in relation to equity shares are equally faced in relation to preference shares (including convertible preference shares).	• It is suggested that the flexibility proposed to be provided under Rule 11UA(2)(c)/(e), Rule 11UA(3) and Rule 11UA(4) in relation to price matching facility, validity of valuation report for 90 days and safe harbour of 10% be extended to valuation of preference shares also.

B. Key observations and recommendation on entities notified under 56(2)(viib)(ii) vide Notification No. 29/2023 dated 24th May 2023 (Notification)

<table>
<tr><th>Particulars</th><th>Key observations</th><th>Recommendation</th></tr>
<tr>
<td>Following classes of non-resident investors have been excluded from the provisions of section 56(2)(viib) vide the Notification:

(I) Government and Government related investors such as central banks, sovereign wealth funds, international or multilateral organizations or agencies including entities controlled by the Government or where direct or indirect ownership of the Government is 75% or more.

(II) Banks or Entities involved in Insurance Business where such entity is subject to applicable regulations in the country where it is established or incorporated or is a resident.

(III) Any of the following entities, which is a resident of 21 countries listed at Annexure to Notification and such entity is subject to applicable regulations in the where it is established or incorporated or resident
a. Entities registered with Securities and Exchange Board of India as Category-I Foreign Portfolio Investors (FPIs);
b. Endowment Funds associated with a university, hospitals or charities;
c. Pension Funds created or established under the law of the foreign country or specified territory;
d. Broad Based Pooled Investment Vehicle or Fund where the number of investors in such vehicle or fund is more than 50 and such fund is not a hedge fund or a fund which employs diverse or complex trading strategies.</td>
<td><u>Extension of exemption for FDI from FATF whitelist countries</u>

• Given that section 56(2)(viib) of the Act is an anti-abuse provision introduced to curb money laundering, strategic FDI into Indian companies from all jurisdictions other than those identified by FATF for increased monitoring (“grey list”) or high risk jurisdictions (“black list”) should not be subjected to angel tax provisions. This is important for the investment climate in the country given the role capital flows via FDI in boosting infrastructure, increasing productivity and creating employment.

<u>Expansion of list of jurisdictions for certain categories of investors</u>

• Without prejudice to the above, It is not clear why the first three sub-categories under the third category of NR investors (viz. SEBI registered Category I FPI investors, endowment funds and pension funds) should have further condition of being regulated and established, incorporated or resident in 21 jurisdictions listed in the Annexure. SEBI registered Category I FPI investors are subject to disclosure requirement of beneficial owners under SEBI regulations. Also, India has wide network of Tax Information Exchange framework under DTAAs and Multilateral Agreements. Hence, for these sub-categories there should be no jurisdiction based requirement. At the highest, the list of jurisdictions should be very wide which covers all FATF white list countries and/or countries with which India has Exchange of Information network.</td>
<td>• Notification should be amended to include all non-resident entities investing from jurisdictions other than those identified by FATF as falling in grey list or blacklist.

• The requirement of being regulated and established, incorporated or resident in 21 jurisdictions listed in the Annexure should be removed for first three sub-categories of investors (viz. SEBI registered Category I FPI investors, endowment funds and pension funds) in the third category. Alternatively, there should be a wider list of jurisdictions for these categories of investors which covers all FATF white list countries and/or countries with which India has Exchange of Information network.</td>
</tr>
</table>

Particulars	Key observations	Recommendation
Further, the Notification is silent on the effective date of application.	**<u>Addition to the list of countries included in the notification</u>** • The Annexure to the Notification lists 21 countries viz. Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Iceland, Israel, Italy, Japan, Korea, New Zealand, Norway, Russia, Spain, Sweden, United Kingdom, United States. • It is not clear why some prominent well-regulated jurisdictions such as Singapore, Mauritius, Netherlands, Luxemburg from which India receives significant FDI are excluded from the above referred list. Excluding such prominent jurisdictions will create tax hurdle by way of angel tax for soliciting FDI from investors coming from such jurisdictions. **<u>Investment through controlled entities</u>** • Furthermore, for diverse commercial reasons like leverage and co-investor participation, the global funds invest in India through entities that are owned or controlled by entities referred in Notification. The Notification recognises this aspect in Government related investors when it refers to entities in which direct or indirect ownership of the Government is 75% or more. Similarly, it is recommended that entities in which at least 75% is directly or indirectly held by one or more of the excluded entities referred in the Notification may also be exempted from angel tax.	• Without prejudice to our above requests, it is recommended that the list of countries as per Annexure in point (iii) of the notification, be expanded to cover countries like Singapore, Mauritius, Netherlands and Luxembourg. • Additionally, entities in which at least 75% is directly or indirectly held by one or more of the excluded entities should also be included in the Notification.

Particulars	Key observations	Recommendation
	<u>Effective date of Notification No.29/2023</u> • While Notification No. 30/2023 in relation to non-resident investment in DPIIT registered start ups is made applicable with retrospective effect from 1 April 2023, Notification No. 29/2023 in relation to notified categories of non-resident investors is made applicable from date of notification viz. 24 May 2023. • This will create challenges for investments made by entities referred in Notification no. 29/2023 in closely held companies between 1 April 2023 and 23 May 2023 which can be susceptible to valuation disputes.	It is recommended that Notification No. 29/2023 be also made retrospectively applicable from 1 April 2023 to avoid any valuation dispute.

C. Clarity on non-applicability of angel tax to issue of shares on conversion of convertible instruments which were issued prior to 1 April 2023

- There could many cases where convertible instruments (like Compulsorily Convertible Debentures or Compulsorily Convertible Preference Shares) are issued prior to 1 April 2023 but get converted post 1 April 2023 at exchange ratio fixed prior to amendment. Such conversions post amendment may also face difficulty of valuation dispute.

- To give true prospective effect to the amendment, it may also be clarified that the provision will not apply to conversion of convertible instrument (like CCDs or CCPS) into shares on or after 1 April 2023 where the convertible instrument was issued prior to 1 April 2023.