



ICAI/DTC/2018-19/Rep-14

29th May, 2018

Shri Sushil Chandra Ji,
Chairman,
Central Board of Direct Taxes
Ministry of Finance,
Government of India,
North Block,
New Delhi-110 001.



Dear Sir,

Re: Notification No 23/2018, dated 24th May, 2018 amending Rule 11UA omitting reference to term "accountant", thereby making Chartered Accountants ineligible to determine the FMV of unquoted equity shares as per the Discounted Free Cash Flow Method

We have been writing to you from time to time on various issues faced by the assesseees in respect of tax matters. Through this letter, we wish to bring to your kind attention the issues and concerns of ICAI in respect of Notification No. 23/2018, dated 24th May, 2018 amending Rule 11UA omitting reference to the term "Accountant" thereby permitting only a merchant banker to determine the FMV of unquoted equity shares as per the Discounted Free Cash Flow Method. ICAI is unable to appreciate the rationale of this notification, which may not be in the interest of the assesseees.

ICAI, being a partner in nation building, has always been consulted when such changes are being given effect to. With regard to this notification, we wish to make our detailed submissions in respect of the following initiatives/ concerns of ICAI. The detailed submissions have been annexed to this letter.

- Preparation and Issuance of Valuation Standards by ICAI - as a benchmark for Valuation Practices applicable for Chartered Accountants, predominantly recognised role of ICAI in connection with Valuation Standards and systematic training imparted to CA students as a part of course curriculum as also in post qualification course to CAs;
- Professional competence of Chartered Accountants - Recognition by Judicial Forum as sole expert in the area of accounting, auditing as well as connected valuations;
- Section 247 of the Companies Act, 2013 recognizes chartered accountant to be eligible for registering as a valuer;
- Very limited number of registered Intermediaries (Merchant Bankers) compared to large number of companies getting covered by the impugned Rule; Chartered Accountants entitled to be registered valuers under the Wealth Tax Rules;

- Valuation Standards Board of ICAI - Focus on in-depth and comprehensive activities performed by Chartered Accountants in respect of valuation;
- Recognition of Accountant in line with Rule-11UA(1)(c).

It is pertinent to mention that limited availability of the merchant bankers would further lead to increase in cost to the assessee for determining the FMV of unquoted equity shares. This, for sure, is neither the intent of the Government nor the same is in line with the objective of the Government of "ease of doing business". Such a situation can be easily avoided if the said notification is reconsidered and status quo before the notification is maintained.

We hope that our concerns would be favourably considered and the said amendment in Rules 11U and 11UA will be reconsidered in the light of this representation.

Thanking you,

Warm Regards,



CA. Tarun Jamnadas Ghia
Chairman, Direct Taxes Committee, ICAI



CONCERNS OF ICAI ON AMENDED RULE 11U AND RULE 11UA VIDE NOTIFICATION NO. 23/2018, Dated 24th MAY, 2018 ISSUED BY THE CBDT

Rule 11UA provides for the manner of determining the fair market value of various specified assets under section 56 of the Income-tax Act, 1961. Sub-Rule (2) of Rule 11UA provides an option to the assessee to determine the FMV of the unquoted equity shares for the purposes of clause (a)(i) of Explanation to section 56(2)(viib) either in the manner specified therein or to get it determined by a merchant banker or an accountant. However, w.e.f. 24.05.2018, vide the above notification, the term accountant has been omitted from Rule 11UA(2)(b).

Valuation of business, financial instruments and other assets has been gaining importance over the period of time and is considered as one of the most critical areas in finance, in particular after the implementation of Ind-AS and it plays a key role in financial reporting and in other areas of finance such as buy/sell, solvency, merger and acquisition.

ICAI is unable to appreciate the rationale of this notification, which may not be in the interest of the assesseees. One will appreciate that the Chartered Accountancy qualification is a blend of financial management, strategic management and financial reporting which provides a focused understanding and concentrate on valuation and thus, the student who qualifies as a Chartered Accountant is sufficiently equipped to independently undertake Valuation Assignments.

Some of the initiatives taken as also the concerns regarding this amendment which need your specific attention have been enlisted below for consideration:

1.	Preparation and Issuance of Valuation Standards by ICAI - as a benchmark for Valuation Practices applicable for Chartered Accountants
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Recognising the need to have the consistent, uniform and transparent valuation policies and harmonise the diverse practices in use in India, recently, the Council of the Institute of Chartered Accountants of India (ICAI) at its 375th Meeting held from 24th May, 2018 to 26th May, 2018 has issued the Valuation Standards. This is one of the first initiatives of its kind that has been taken up in India by ICAI.



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The Valuation Standards have been issued by ICAI to set up concepts, principles and procedures which are generally accepted internationally having regard to legal framework and practices prevalent in India. With a vision to promote best practices in this niche area of practice, the Standards lay down a framework for the chartered accountants to ensure uniformity in approach and quality of valuation output. Among many other aspects, the standards include:

- Framework for the Preparation of Valuation Report
- Valuation Bases, approaches and methods
- Scope of Work, Analyses and Evaluations
- Documentation and Reporting
- Business Valuation
- Intangible Assets
- Financial Instruments

Applicability of Valuation Standards:

- For Chartered Accountants providing Valuation Reports under various provisions of the Companies Act, 2013, compliance of these Valuation Standards is mandatory.
- For valuation under other Statutes, it is recommendatory to comply with these valuation standards. Chartered accountants have however been requested to comply with the same as a good practice.

In formulating the Valuation Standards, ICAI has considered the best valuation practices followed globally as well as in India, uniqueness of Indian conditions, current practices in India along with their advantages and disadvantages and various purposes for which valuations might be required over and above the requirements of Companies Act. These standards have been evolved as a result of ICAI's consistent drive to guide its members for ensuring high quality work and standards.

Even though valuation standards require the chartered accountant to value in a particular manner, it also recognises the manner of valuation provided for in specific legislations. Here it is pertinent to quote the relevant extracts of the Indian Valuation Standard 102, Valuation Bases which provides the following:

“In some engagements, a valuer is required to adopt valuation base that is prescribed by regulations or agreement/ arrangement between the parties. In those cases,



considering the relevant regulations, agreement or arrangement, such bases need to be applied, for example as per the requirements under:

(i) Income Tax Act;

(ii) SEBI Regulations; or

(iii) The Insolvency and Bankruptcy Code.”

Considering the fact that ICAI has not only been instrumental in maintaining the competencies of its members in the arena of valuation, but also understands its responsibility towards regulating the valuation practice of its members, the omission of reference to “accountant” in Rule 11UA(2)(b) is uncalled for. This amendment requires serious reconsideration in light of above-mentioned measures taken by ICAI.

2.	Professional competence of Chartered Accountants - Recognition by Judicial Forum as sole expert in the area of accounting, auditing as well as connected valuations
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Considering the accounting and Auditing competencies of chartered accountants, the onerous responsibilities of various certifications under the provisions of Income-tax Act, 1961 have been laid upon them. Even the Apex Court has put its seal of approval by upholding expertise of Chartered accountants in the field of accounting and auditing in *T.D. Venkata Rao v Union of India* [1999] 237 ITR 315 (SC). The Apex Court has made the following significant observations:

"Chartered Accountants, by reason of their training have special aptitude in the matter of audits. It is reasonable that they, who form a class by themselves, should be required to audit the accounts of businesses whose income (sic: turnover) exceeds Rs.40 lakhs (now Rs.1 crore) and professionals whose income (sic: gross receipts) exceeds Rs.10 lakhs (now Rs.25 lakh) in any given year. There is no material on record and indeed in our view, there cannot be that an income-tax practitioner has the same expertise as chartered accountants in the matter of accounts."

There are several High Court judgments as well, like *Sarma (A.S.) v. Union of India* [1989] 175 ITR 254 (AP); *Nataraj (T.S.) v. Union of India* [1985] 155 ITR 81(Kar.); *Rajkot Engineering Association v. Union of India* [1986] 162 ITR 28(Guj.), which have clarified that audit and accounts are the exclusive domain of Chartered Accountants.



In the context of valuation of unquoted equity shares, it is also noteworthy to mention that the syllabus of CA Final Paper 2 Strategic Financial Management includes a dedicated topic on securities valuation, wherein the theory of valuation, discount rate selection in relation to cash flows and different approaches to valuation of equity shares are being extensively dealt with. Strategic Financial Management is one of the core papers of the Final Course, wherein higher level skills of evaluation and synthesis of an aspiring chartered accountant are assessed.

Also, in *Gujarat High Court in Kamala Sugar Mills Limited 55 Company Cases P.308* dealing with an identical objection about the exchange ratio adopted in the Scheme of Compromise and Arrangement; the Court observed as under:

*"Once the exchange ratio of the shares of the transferee-company to be allotted to the shareholders of the transferor-company has been worked out by a recognised firm of chartered accountants **who are experts in the field of valuation** and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be determined to their interest."*

Later on, referring to the above Gujarat High Court Judgement, in the case of *Miheer H. Mafatlal vs Mafatlal Industries Ltd* {JT 1996 (8) 205} on 11th September, 1996, the Apex Court observed the following:

"These observations in our view represent the correct legal position on this aspect. We may also keep in view that in the present case not only expert like M/s C.C., Chokshi & Co. had suggested the ratio but another independent body ICICI Security & Finance Company Limited reached the same conclusion which was conveyed by its letter dated 10th November 1993 to the company approving of the entire Scheme along with the suggested ratio. A mere look at the report of the Chartered Accountants M/s C.C. Chokshi & Co. shows that various factors underlying the Scheme of Compromise and Arrangement were taken into consideration while suggesting the exchange ratio by the said reputed firm of chartered accountants."



It is pertinent to mention that the manner of valuation provided by Rule 11UA(2)(b) predominantly mentions application of discounted cash flow method. A chartered accountant has the desired level of professional competence as also the understanding of the business and cash flow projections, is well equipped to, *inter alia*, undertake valuation of shares.

3.	Section 247 of the Companies Act, 2013 recognizes chartered accountant to be eligible for registering as a valuer
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Chapter XVII of the Companies Act, 2013 deals with Registered Valuers. Section 247 (**Valuation by registered valuers**) provides that — *(1) Where a valuation is required to be made in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets (herein referred to as the assets) or net worth of a company or its liabilities under the provision of this Act, it shall be valued by a person having such qualifications and experience and registered as a valuer in such manner, on such terms and conditions as may be prescribed and appointed by the audit committee or in its absence by the Board of Directors of that company.*

Accordingly, Rules in this regard are issued by the Government (Companies (Registered Valuers and Valuation) Rules, 2017). In accordance with these Rules ICAI has formed ICAI Registered Valuers Organisation. This is a section 8 Company formed to enroll and regulate registered valuers as its members. This organisation carries out the functions of the Registered Valuers Organisation under the Companies (Registered Valuers and Valuation) Rules, 2018, and functions incidental thereto.

These Rules recognize the qualification of Chartered Accountant as eligible to be registered as a valuer for the course on valuation conducted by Registered Valuers Organization, examination of which is conducted by Insolvency and Bankruptcy Board of India (set up under the Insolvency and Bankruptcy Code, 2016).

The 50 hours educational course for ICAI Registered Valuers Organisation (a Section 8 company formed by ICAI) has commenced. It is an extensive training covering all aspects of valuation, case studies, finance, financial statement analysis, judicial pronouncements etc.

The qualifying education, experience and examination or training for various asset classes, is given in an indicative matrix in Companies (Registered Valuers and



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valuation) Rules, 2017. The relevant Indicative Matrix on requisite qualifications/ experience in **Securities or Financial Assets** specified discipline –

Asset Class	Graduate	Post Graduate	Experience	Valuation Specific Education
Securities or Financial Assets	Graduate in any stream	(1) Member of the Institute Chartered Accountants or The Institute of Cost Accountants of India or the Institute of Company Secretaries of India; (2) MBA/PGDBM specialization in finance or;	3 years of experience in the discipline after completing graduation	Courses as per syllabus prescribed under Rule 5
	Any other graduate level qualification in accordance with Rule 4 as may be specified by the authority for a registered valuers organisation in its conditions of recognition	Any other graduate level qualification in accordance with Rule 4 as may be specified by the authority for a registered valuers organisation in its conditions of recognition	At least five years and three years of experience in case of graduate level degree or post graduate level degree respectively;	Courses as per syllabus prescribed under Rule 5

Since the Companies Act, 2013 allows a chartered accountant to act as valuer of assets including, shares and securities, a chartered accountant should also be



permitted to act as a valuer of equity shares for income tax purposes as per the Income-tax Act, 1961.

4.	Limited registered Intermediaries (Merchant Bankers)
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As per SEBI, as on date, there are only 195 Intermediaries (Merchant Bankers) (Source: <https://www.sebi.gov.in/sebiweb/other/OtherAction.do?doRecognisedFpi=yes&intmId=9>). These merchant bankers are generally available in metro cities. In comparison to the same, there are around 3 lakh chartered accountants who were till date eligible to determine the fair market value of the unquoted shares. All the more, these chartered accountants are not limited only to metros but are spread all over India.

As on 31st March, 2018, there were only 11,59,945 active companies out of which 10,88,657 were private and 71,288 were public companies. Out of these public companies, 64,049 were unlisted companies. In all there are 11,52,706 unlisted companies. With the amendment in Rule 11UA, due to deletion of the term 'Accountant' from Rule 11UA(2)(b), for the purposes of the required valuation, these 11 Lakhs + companies will have to go to only 195 Merchant bankers as compared to earlier regime wherein they had the option to go to an accountant.

As a result, the option for the concerned tax payer has been ultimately reduced to a few hundred from more than a lakh options available earlier. This would cause undue hardship to the assessee. Limited availability of the merchant bankers would further lead to increase in cost to the assessee for determining the FMV of unquoted equity shares. This, for sure, is neither the intent of the Government nor the same is in line with the objective of the Government of "ease of doing business". Such a situation can be easily avoided if the said notification is reconsidered and status quo before the notification is maintained.

Further, it would be pertinent to mention that the merchant bankers are employing good number of chartered accountants and for the impugned valuations also, they would ultimately be utilising the services of CAs. Therefore, in all probability, the impugned valuations would be prepared by CAs. However, this will create a very unreasonable situation, where a CA would not be entitled to undertake valuation on the merit of his own qualification, whereas he would be titled to do so on behalf of a merchant banker. Such a situation is not desirable. In this context, it is



noteworthy to mention that RBI with reference to FEMA, FDI etc has been regularly making use of the services of CAs to issue certificate on the discounted cash flow.

5.	Chartered Accountants entitled to be registered valuers under the Wealth Tax Rules
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Taking into consideration the core competencies of chartered accountants, the Wealth Tax Act, 1957 has recognised them as a registered valuer for issuing valuation reports pertaining to stocks, shares, debentures, securities, shares in partnership firms and of business assets, including goodwill but excluding those referred to in sub-rules (2) to (6) and (8) to (11) of Rule 8A of Wealth-tax Rules, 1957 (Rule 8A(7)).

Since the Chartered accountants were allowed to be valuers under the wealth tax rules for valuation of shares, applying the same rationale they should be allowed to value unquoted equity shares for the purpose of Rule 11UA(2)(b).

6.	Valuation Standards Board of ICAI- Focus on activities performed by Chartered Accountants in respect of valuation
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ICAI has been continuously working towards enhancing the capabilities of its members in all fields of practice. One such field on which ICAI has focused is valuation. In order to enable our member chartered accountants to effectively and efficiently perform their functions as valuers, ICAI has formed a 'Valuation Standards Board'. With regard to the same, we wish to draw your attention specifically to the following:

- The Valuation Standards Board focuses on the release of Indian Valuation Standards, providing Interpretations, Guidance and Technical Materials from time to time and implementation of the Standards and so on.
- The composition of this Board is fairly broad-based and ensures participation of all interest groups in the standard-setting process. Apart from the elected members of the Council of the ICAI nominated on the VSB, the Board also has, *inter alia*, a representative of Central Board of Direct Taxes.



- ICAI conducted Certificate Course on Valuation for its members, wherein it imparts training and expertise in taking up Valuation assignments. The participants undergo a written examination before being awarded the certificate for Valuation. The course is more of brainstorming sessions and participants are exposed to undergo virtual stimulation exercise. The course is in operation for the last eight years and the syllabi is at par excellence with other courses run internationally.
- ICAI has successfully trained more than 3400 of its members through its much acclaimed and stringent course on Valuation. It is to be noted that valuation required under the Companies Act, 2013 and the Income-tax Act, 1961 is entirely in the nature of financial valuation, involving application of accounting and finance. Therefore, Chartered Accountants are best suited to be the Registered Valuers in cases involving financial valuation.

Considering the fact that ICAI is making all efforts to ensure that the chartered accountants efficiently and effectively perform their role as a valuer, the amendment in the Rule 11UA may be reconsidered.

7.	Recognition of Accountant in line with Rule 11UA(1)(c)
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Rule 11UA(1)(c) provides that for the purposes of section 56, the fair market value of unquoted shares and securities other than equity shares in a company which are not listed in any recognized stock exchange shall be estimated to be a 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 such valuation.

The competencies of the chartered accountant were duly considered by CBDT in the year 2012 while notifying Rule 11UA(2) and thus an accountant along with the merchant banker was duly allowed to determine the fair market value of unquoted equity shares as per Discounted Free Cash Flow Method.

Even though the provisions of section 11UA(1)(c) still recognize an accountant to be eligible to determine the FMV of unquoted shares and securities, the term “accountant” has been omitted from Rule 11UA(2) specifically dealing with unquoted equity shares.



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This omission of the term "Accountant" after successful implementation of the provision for six long years may be reconsidered in light of the above submissions.

Warm Regards,

CA. Tarun Jamnadas Ghia
Chairman, Direct Taxes Committee, ICAI

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