Preface

This article covers taxation under Income Tax Act in case of sale of unlisted shares by one shareholder to another person. This transaction does not cover taxation in the hands of the domestic company as the company is not the party to this particular transaction.

We hope that this publication gives you an insight into the subject matter.

Thank you.

Disclaimer

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Transaction being covered

The transaction in consideration is of transfer of shares of an unlisted domestic company by a shareholder to another person, who may or may not be an existing shareholder. Tax impact in the hands of the seller as well as buyer will be taken into consideration.

Tax Impact from Seller's View

1. **Cost of asset**

   The cost of shares that are being sold, will be the cost incurred to acquire the shares being sold. In case, the shares are acquired by inheritance or gift, then cost to the previous owner, along with the stamp duty on such transfer, will be the cost of the asset.

2. **Sale Consideration**

   The Sale consideration will be the value at which the shares are being transferred from the Seller to the buyer.

3. **Short Term Capital Gain**

   The Transaction of sale will be considered as Short-Term Capital Gain, if the period of holding of such shares is less than 24 months. In case, shares are acquired by inheritance or gift, then period of holding of previous year will also be considered.

   The Tax Rate in case of Short-term Capital Gain of Unlisted shares of a domestic company shall be **applicable slab rate.**

4. **Long Term Capital Gain (Section 112)**

   The Transaction of sale will be considered as Long-Term Capital Gain, if the period of holding of such shares is more than 24 months. In case, shares are acquired by inheritance or gift, then period of holding of previous year will also be considered.

   In this case, Indexation will be available to ascertain the cost. The Indexed Cost shall be Cost of Acquisition * CII of Year of Sale / CII of Year of Purchase

   The Tax Rate in case of Long-term Capital Gain of Unlisted shares of a domestic company shall be **20%.**

5. Computation of Capital Gain

The Capital Gain is computed as below :
Capital Gain = Full Value of Consideration (Section 50CA)
(less) Cost of Acquisition (Indexed Cost in case of LTCG)
(less) Transfer Expenses

6. Full Value of Consideration (Section 50CA)

Where an unlisted share of domestic company is being transferred, then the full value of consideration shall be the **higher of Fair Market Value or the Sale Consideration**.

The Fair Market Value will have to be determined as per Rule 11UAA. This report can be obtained from a merchant banker or a Chartered Accountant.

7. Fair Market Value (Rule 11UAA)

Fair Market Value of unquoted shares = (A + B + C + D – L) X (PV) / (PE)

Here,

A = Book value of all assets (other than jewellery, shares, securities and immovable property) (less) Income Tax paid net of refund (less) any amount shown as asset, which does not represent the value of asset e.g. deferred tax.

B = Value of Jewellery as per Valuation Report from a registered Valuer

C = FMV of shares and securities as determined in the manner provided in this rule.

D = Value adopted for the purpose of Stamp duty by the Government authority for an Immovable property.

L = Book Value of all liabilities, but not including;

- Paid-up capital of equity shares
- Amount set apart for dividend, which has not been declared till the date of transfer in the general body meeting of the company
- Reserves and surplus, other than those set apart for Depreciation
- Amounts towards provision for Income Tax and Provisions for liability other than those ascertained
- Contingent liabilities, other than arrears of dividend payable on cumulative preference shares.

PV = Paid up value of equity shares

PE= Paid up equity share capital as per Balance sheet

Tax Impact from Buyer's View

The Buyer of an unlisted equity shares will have tax implication involved in this transaction, only in case such share is acquired for an inadequate consideration.

Inadequate consideration will mean that the shares are acquired at a cost which is less than the Fair Market Value (As computed under Rule 11UAA).

Here, if the difference between the Cost of Acquisition and the Fair Market Value exceeds Rs.50,000, then such difference will be taxable in the hands of Buyer as **"Income from Other Sources".** This means, tax applicable shall be the **Slab Rates**.

To Summarise

The Parties to the transaction must ensure that the consideration for this transaction is above the Fair Market Value.

If the value is less, then both the Seller as well as Buyer will have tax implications involved at higher value, instead of simply the Capital Gains at transaction value in case of Seller.

Also, for ROC (Registrar of Companies), stamp duty on transfer of unlisted shares will be applicable on the Fair Market Value.

Publisher

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