
(1997) 11 MAD CK 0106
In the Madras High Court
Case No : TC No"s. 1069 and 1070 of 1985

Commissioner of Gift Tax

APPELLANT

Vs

S. Naganathan

RESPONDENT

Date of Decision : 28-11-1997

Acts Referred:

Gift Tax Act, 1958 — Section 15(6), 16, 4(1), 6
Income Tax Act, 1961 — Section 28

Citation : (1999) 239 ITR 822

Hon'ble Judges : P. Thangavel, J; N.V. Balasubramanian, J

Bench : Division Bench

Advocate : Deokinandan, for the Appellant; K.M.L. Majele, for the Respondent

Judgement

N.V. Balasubramanian, J.—In pursuance of the directions of this Court in TCP Nos. 446 & 447 of 1983, dt. 9th January, 1984, the

Tribunal has referred the following question of law for our consideration :

Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the ITO was not justified in adding the difference

between the fair market value of the shares and the consideration received as deemed gift under s. 4(1)(a) of the GT Act, 1958 ?

2. The matter arises under the GT Act and relates to two assessment years, namely 1972-73 and 1973-74. The assessee during the course of

previous year relevant to the asst. yr. 1972-73 sold fifty equity shares in M/s Haritha Pvt. Ltd. for a sum of Rs. 61,808 apart from four shares

gifted by him. The GTO, however, determined the value of the shares at Rs. 4,577.94 per share based on the break up value worked out by

substituting the fair market value of Rs. 26,92,400 for land and buildings estimated by the District Valuation Officer of its Department in the

reference made under s. 15(6) of the GT Act, 1958 (hereinafter to be referred to as "the Act") for the balance sheet figure of Rs. 6,07,348 for the

land and buildings as on 30th September, 1971. The GTO adopted the market value of the land and buildings and determined the value of the

shares transferred by way of gift as well as the sale which came to Rs. 2,47,209 as against nil consideration in money's worth in respect of four

shares gifted and consideration of Rs. 61,808 in respect of fifty shares sold. The GTO, accordingly, computed the chargeable gift at Rs. 1,85,401

comprising of direct gifts of Rs. 18,312 and deemed gift under s. 4(1)(a) of the Act of Rs. 1,67,089. After deducting a sum of Rs. 4,880 which

was admitted as gift, the GTO added the difference of Rs. 1,80,521 and completed the assessment for the asst. yr. 1972-73. For the asst. yr.

1973-74, the assessee sold seventy three shares held in M/s Haritha Pvt. Ltd. and the GTO computed the deemed gift following the same process

adopted for the earlier assessment year and determined the deemed gift under s. 4(1)(a) of the Act at Rs. 2,40,165 and completed the assessment.

3. The assessee went on appeal to the AAC for the asst. yr. 1972-73 and to the CIT(A) for the asst. yr. 1973-74. The AAC as well as the

CIT(A) held that the market value of the shares could not have been higher than the price on which the shares were sold or the value for which

they were gifted away. They also found that the procedure adopted by the GTO for valuation for the immovable property separately and then,

valuing the individual shares was not correct and in this view of the matter, the AAC and the CIT(A) held that the provisions of s. 4(1)(a) of the

Act were not attracted by the facts of the case.

4. The Revenue carried the matter by way of appeals before the Tribunal. The Tribunal in a lengthy order found that the best evidence of fair

market value is the price of the shares at which the shares were purchased or sold. He noticed, the working adopted by the assessee in the original

assessment and the working adopted by the Department as under :

Assessee's working accepted in the original assessment :

Valuation of shares as on 30th September, 1971 : asst. yr. 1972-73 :

Rs.

Break-up 6,00,000

Capital paid-up 61,709

Reserves 6,61,709

Capitalisation of Profits :

Rs.

Year ended 30-9-1967 67,834

30-9-1968 59,367

30-9-1969 66,725

30-9-1970 1,14,848

30-9-1971 88,577

Maintainable profits

1/5th of Rs. 3,97,551 79,510

Capitalised value Rs. 79,510 x 100

----- = 8,83,444

9

15,45,153

Average : Rs. 15,45,153

----- = 7,72,576.50

2 -----

or say : 7,72,577

Value of each share : 7,72,577

----- = Rs. 1,288

600

Department's working in the reassessment :

Rs.

Paid-up Capital 6,00,000

Reserves 61,709

6,61,709

Rs. Rs.

Value of land and buildings 26,92,400

Less : Book value 6,07,348 20,85,052

Value of 600 equity shares 27,46,761

Value of each share : 27,46,761 4,577.94

600

The Tribunal found that there have been many transactions between the members of the family with reference to the shares as between them and

the Union Company Motors Private Limited and all the transactions were at Rs. 1,288 per share and in this view of the matter, the Tribunal came

to the conclusion that the price paid is the real price in the absence of a suggestion that there was any collusion or the transactions were below the

market value. The Tribunal, therefore, held that there was no warrant for assuming that the market value would be higher than the sum of Rs. 1,288

per share which was the price when the shares were sold by the assessee. The Tribunal also found that the valuation of the shares was done in

consequence of the Board's Circular No. 2(WT)/1967, dt. 31st October, 1967, and when the assessee adopted a recognised method of

valuation of shares, it is not open to the Revenue to substitute the book value of the assets for the market value of the shares. It also found that the

method adopted was to find out the average of the break-up valuation of shares as per the balance sheet and the capitalised value of shares on the

basis of maintainable profits and it is only on the basis of the Board's Circular, the valuation had been done by the assessee with reference to the

shares sold by him. The Tribunal also held that the Board Circular No. 2(WT)/1967, dt. 31st October, 1967, would equally apply for the

proceedings under the GT Act and, therefore, the Tribunal came to the conclusion that the value at which the shares were sold by the assessee was

correct and when the assessee adopted one method of valuation to value the shares, it is not open to the AO to adopt another method in valuing

the shares for the purpose of reassessment. The Tribunal, however, upheld the

question of jurisdiction of the AO in so far as the asst. yr. 1973-74

is concerned as it was a case of reassessment under s. 16(b) of the Act. In this view of the matter, the Tribunal dismissed the appeals preferred by

the Revenue though it upheld the question of jurisdiction of the GTO to reopen the assessment.

5. Mr. C. V. Rajan, learned counsel for the Revenue, submitted that under the provisions of the GT Act, the valuation of the shares have to be

done on the basis of the market value of the shares and there are no rules framed under the Act to determine the value of the shares held by the

assessee in a company which is admittedly an investment company and in the absence of any statutory rule, the GTO will be only guided by the

provisions of s. 6 of the Act and it is open to the GTO to depart from the value shown in the balance sheet of the company and to substitute the

market value of the assets instead of the book value as shown in the balance sheet. He therefore, submitted that when the difference between the

two values is so great, it is open to the GTO to adopt the market value of the assets and, therefore, the Tribunal was not correct in holding that the

average between the yield method and the break-up method should be adopted. He further submitted that in so far as the asst. yr. 1972-73 is

concerned, it is a case of original assessment and the Tribunal earlier applied the principles which are applicable for reassessment to the gift in the

original assessment as well. He also submitted that the Board's circular made for the WT Act are not applicable to the provisions of GT Act and,

therefore, the GTO was justified in valuing the land and buildings at the market value.

6. Mr. Janarthana Raja, learned counsel for the assessee, on the other hand, submitted that the assessee had valued the shares according to the

method authorised by the Board though the circular was withdrawn subsequently and there is no reason to presume that there was any

understatement and where the stated consideration of the assessee was justified on the basis of the recognised method of valuation, the value at

which the shares were sold would represent the fair market value.

7. We have carefully considered the rival submissions of the learned counsel for the respective parties. Mr. C. V. Rajan is justified by his

submission that the assets for the purpose of gift-tax should be valued at fair

market value under the provisions of s. 6 of the Act and in the absence of any statutory rule, nothing forbids the GTO to value the shares to determine the correct fair market value of the shares on the date of

transfer. However, it is significant to notice that the assessee had valued the shares on the basis of a circular issued by the CBDT in Circular No.

2(WT), dt. 31st October, 1967. The said circular, in so far as it is relevant for the purpose of this case is concerned, reads as under :

Unquoted equity shares of investment companies other than those which are substantially holding companies-An investment company has been

defined in r. 1AA(g) of the WT Rules, 1957, as a company whose total income consists mainly of income which, if it had been the income of an

individual, would be regarded as unearned income. Unearned income means all income other than "earned income" as defined in the Finance Act

of the relevant year. Although the definition of investment company would not cover a banking/insurance company, but to avoid all doubts in the

matter, it is clarified that banking and insurance companies will not be treated as investment companies. Their shares will be valued under r. 1D of

the WT Rules, 1957.

The average of (a) the break-up value of the shares based on the book value of the assets and liabilities disclosed in the balance sheet, and (b) the

capitalised value arrived at by applying a rate of yield of 9 per cent. of its maintainable profits, will be taken to represent the fair market value of the

shares of an investment company. Maintainable profits of a company should be calculated as under (i) The book profits of the company for the five

years immediately preceding the valuation date will be ascertained.

(ii) Adjustments will be made to the book profits of each of the said five years for all non-recurring and extraordinary items of income and

expenditure and losses.

(iii) Adjustments will be made for expenditure, which is not of a revenue nature and is debited in the accounts and for receipts, which are revenue

receipts and are not accounted for in the P&L a/c.

(iv) The development rebate, in case it is debited in the books of account, will be added back.

(v) The appropriate tax liability of the company on the book profits as determined will be deducted.

(vi) The profits required for paying dividends on shares with prior rights, i.e., preference shares shall be excluded.

(vii) The average of the company's book profits as adjusted above, will be determined.

The maintainable profits thus arrived at will be capitalised, as stated above, by adopting 9 per cent. rate of capitalisation.

8. The Board subsequently issued another circular dt. 15th September, 1973, modifying some of the original instructions found in the earlier

circular. The relevant portion of the subsequent circular dt. 15th September, 1973, reads as under :

In arriving at the estimated price which a share of such company would fetch if sold in open market on the relevant valuation date, its asset

backing must be carefully computed, in accordance with well-settled principles. In other words, the valuation should take into account the

complete enterprise consisting of the parent investment company and its wholly-owned subsidiary or subsidiaries as if they were only one

company. In arriving at such computation, the reserves of the subsidiary company must necessarily be taken into account".

9. The assessee undoubtedly valued the shares in accordance with the circulars of the Board by adopting the average of the break-up value of the

shares based on the book value of the assets and liabilities disclosed in the balance sheet, and the yield method on the basis of the maintainable

profits. The company is undoubtedly an investment company. When the assessee had valued the shares on the basis of the circular issued by the

CBDT, it can easily be said that the valuation of the shares made by the assessee was in accordance with a recognised method of valuation. In

addition, it is also relevant to notice that the Board has merely modified the earlier circular after the decision of the Supreme Court in

Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc., , which was decided by the Supreme Court on 13th

September, 1972, before the issue of clarificatory circular on 15th September, 1973. The fact that the Board has issued a circular retaining its

earlier circular dt. 31st October, 1967, even after the decision of the Supreme Court in Mahadeo Jalan's case, cited supra clearly shows that the

circular was in force during the previous year relevant to the assessment year in question. The mere fact that the circulars were issued under the

WT Act would not prevent its application for the determination of valuation of the shares under the GT Act, as Courts have taken the view that the principles adopted under the WT Act to determine the value of an asset can equally be applied for the determination of the value of the asset for the gift-tax as well. The rules regarding the valuation of shares under the provisions of GT Act came into force only by the Direct Taxes (Amendment) Act, 1989, w.e.f. 1st April, 1989, and prior to the introduction of the rules, the assessee had to value the shares on the basis of the circulars issued by the CBDT. The Board has issued the circular only with a view that there should be an uniform method of valuation in the valuation of shares. No doubt, it is open to the GTO or the WTO to depart from the circulars issued by the Board where the difference between the market value determined according to the Board's circulars is so swelling and value returned did not really reflect the fair market value of the shares and in the absence of any finding by the GTO to that effect, we are of the view that the Tribunal has come to the correct conclusion in holding that the value returned by the assessee cannot be stated to be inadequate to attract the provisions of s. 4(1)(a) of the Act. In this regard, the decision of the Gujarat High Court in Rajan Ramkrishna Vs. Commissioner of Wealth-tax, Gujarat-I, would also apply to the facts of the case.

10. Further, this Court in Commissioner of Gift-tax Vs. Indo Traders and Agencies (Madras) P. Ltd., , was dealing with the question of applicability of s. 4(1)(a) of the Act and held that the following test should be fulfilled to attract s. 4(1)(a) of the GT Act.

The investigation to be made under s. 4(1)(a) of the GT Act, 1958, can only be to see whether there is any attempt at evasion of tax or whether the relevant transaction is bona fide. If the consideration which passed between the parties can be considered to be reasonable or fair, it cannot be considered to be inadequate. Adequate consideration is not necessarily what is ultimately determined by some one else as market value. Unless the price was such as to shock the conscience of the Court, it would not be possible to hold that the transaction is otherwise than for adequate consideration.

Therefore, where the consideration passed by the parties is fair and reasonable and it was done adopting a prescribed method of valuation and the

price did not shock the conscience of the final fact-finding authority, namely, Tribunal, it is not possible for us to hold that the transaction was made

otherwise than for adequate consideration. Therefore, we hold that the Tribunal was right in holding that the provisions of s. 4(1)(a) of the Act are

not attracted to the facts of the case.

11. The question of law referred to us, in our opinion, should be reframed and accordingly, we reframe the question of law for both the assessment

years as follows :

Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the provisions of s. 4(1)(a) of the GT Act, 1958,

are not attracted to the facts of the case".

Accordingly, we answer the question of law as reframed by us in the affirmative and against the Revenue. However, in the circumstances, there will

be no order as to costs.