(1996) 02 MAD CK 0074

In the Madras High Court

Case No : Tax Case No''s. 1150 and 1151 of 1982

Commissioner of Gift Tax — APPELLANT

Vs

Sundaram Industries Ltd. — RESPONDENT

Date of Decision : 01-02-1996

Acts Referred:
Gift Tax Act, 1958 — Section 26, 4, 6, 6(1)
Wealth Tax Act, 1957 — Section 7

Citation : (1998) 232 ITR 757

Hon'ble Judges : N.V. Balasubramanian, J;K.A. Thanikkachalam, J

Bench : Division Bench

Advocate : C.V. Rajan, for the Appellant; S.A. Balasubramaniam, for the Respondent

Judgement

Thanikkachalam, J.—At the instance of the Department, the Tribunal referred the following two questions for the asst. yrs. 1973-74 and

1974-75 for our opinion, under s. 26(1) of the GT Act, 1956.

1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that there was no undervaluation of shares sold by

the assessee and hence, there was no scope for assessment of any deemed gift ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding the CIT(A)''s order allowing a discount of 30%

while arriving at the break up value of the shares of the company having regard to the factors like non-declaration of dividends in the past and the

restrictive clauses in the articles of association ?

2. The assessee is a company, which sold certain shares in its sister companies during the years under consideration, i.e., during the asst. yr. 1973-

74, the shares of M/s India Motor Parts and Accessories Ltd. and M/s Sundaram

Pvt. Ltd. were sold and during 1974-75, the shares of M/s

Sundaram Fasteners were sold. The GTO was of the opinion that the market value of the shares was higher and so he sought to bring the

difference of Rs. 3,12,702 for the asst. yr. 1973-74 and Rs. 9,45,786 for the asst. yr. 1974-75 to tax. The mode of computation adopted by the

GTO as well as the mode of computation adopted by the assessee were the same; but the reason for the difference has been explained in detail in

the order of the first appellate authority. The GTO and the assessee had followed the method of break up value of the shares; but the GTO

proceeded from the balance sheet nearer to the date of sale, which is subsequent to the date of sale; but the assessee relied on the balance sheet

for the period prior to the date of sale, on the ground that it was the only balance sheet, available on date. The second difference was due to

dispute as to the extent of discount that has to be allowed in ascertaining the market value with reference to the break up value of the shares.

3. On appeal, the CIT(A), followed the guidelines laid down by this Court in Commissioner of Gift-tax Vs. Prema Srinivasan, and some of the

decisions of the Tribunal on the point in respect of the same group of companies. He adopted the guidelines laid down and taking the last available

balance sheets and considered the further estimated profits till the date of sale, subject to adjustment for declaration of bonus shares and dividends

and allowing discount, after reckoning the period of non-declaration of dividends in the past and the nature of the restrictive clause contained in the

articles of association of the respective companies and found that it was nearly the same or less than the value adopted for transfer in the account.

In fact, he found that there was no ground for presuming undervaluation in respect of all the three companies. He, therefore, deleted the additions.

The aggrieved Department filed second appeal before the Tribunal.

Before the Tribunal, the Department raised two contentions. According to the Department the CIT(A) had followed the provisions of r. 1D of the

WT Rules (hereinafter referred to as ''the Rules'' for short), which have no application to gift-tax proceedings. It was submitted that s. 6(1) of the

GT Act prescribes as to the undervaluation and it is not the same as the one under the WT Act. Secondly, it was contended that the discount

allowed by the GTO are reasonable and that there is no case for any further allowance. However, the Tribunal upheld the view expressed by the

CIT(A). It pointed out that discount was provided under r. 1D of the Rules and that this rule merely adopts the well known method of valuation of

shares. If this method, which is well known and is also prescribed for the wealth-tax purposes, is followed, there is no basis for presumption of

understatement of the consideration. Therefore, the Tribunal took the view that there is no scope for presuming any deemed gift for the purpose of

GT Act.

4. Before us, the learned standing counsel appearing for the Department, made two submissions. (1) In view of the decision in Commissioner of

Gift-tax Vs. K. Ramesh, , the balance sheets drawn after the dates of sales, which are nearer to the sales date alone should be taken into

consideration and not the balance sheets earlier to the date of sale. (2) Rule 1D of the Rules is mandatory in nature as per the decision of the

Supreme Court in Bharat Hari Singhania and others Vs. Commissioner of Wealth Tax (Central) and others, and according to the said rule,

discount can be given for sales of the companies, which contained restrictive clauses in their articles of association, to the extent of 15% and in this

case, the discount granted at 30% is against the said provision.

5. According to learned counsel for the assessee, the balance sheets drawn after the date of sale, though nearer in point of time, were not available

to ascertain the true market value of the shares on the date of sale, but the balance sheets which were drawn prior to the date of sale alone were

available, even though they are not so nearer to the date of sale. According to him, in the cases where the date of the balance sheet and the

valuation date of the assessee do not coincide, Expln. I to r. 1D has to be invoked which says that where the date on which the balance sheet is

drawn up does not coincide with the valuation date of the assessee, the balance sheet drawn up on a date immediately preceding the valuation date

shall be adopted, as the basis for working the rule, and yet another situation contemplated by that Explanation is where both the above situations

are absent, the balance sheet drawn up on a date immediately after the valuation date shall be adopted as the basis. According to him, the Tribunal

is, therefore, justified in taking into consideration the balance sheet drawn up immediately preceding the valuation date adopted by the assessee. As regards the discount allowed, the learned counsel pointed out that 30% discount is reasonable in view of the provisions contained in r. 1D and the

table provided thereunder. The learned counsel also submitted that while determining the valuation of the shares, the Tribunal has taken into

consideration the profits to be made from the date of drawing of the balance sheet immediately preceding the date of sale. According to him, the

discount allowed 30% cannot be considered to be unreasonable or against the statute.

6. We have heard learned standing counsel for the Department as well as the learned counsel for the assessee. During the asst. yr. 1973-74, the

shares in M/s India Motor Parts and Accessories Ltd., and M/s Sundaram Pvt. Ltd. were sold and in 1974-75, the shares of M/s Sundaram

Fasteners Ltd. were sold. The assessee showed the sale price of one share of India Motor Parts and Accessories Ltd. at Rs. 109.50 on the basis

of the balance sheet as at 31st March, 1972; but the GTO worked it out Rs. 131.15 per share of the fair market value on the basis of the balance

sheet as at 31st March, 1973. The actual sale took place on 7th February, 1973. In the case of Sundaram Pvt. Ltd., the sale took place on 27th

February, 1972 and the assessee showed the sale price at Rs. 128 per share, on the basis of the balance sheet as at 31st March, 1971; while the

GTO worked it out at Rs. 151.45 per share as per the fair market value on the basis of the balance sheet as at 31st March, 1972. The difference

between the two in the above two cases was Rs. 3,12,702 and it was added back by the GTO as deemed gift under s. 4. In relation to Sundaram

Fasteners Ltd. the price was Rs. 6 per share adopted by the assessee on the basis of the balance sheet as at 31st March, 1973 for the sale that

took place on 14th February, 1974, while the GTO worked it out at Rs. 11.66 per share on the fair market value basis adopting the balance sheet

as at 31st March, 1974. In this case, the difference was Rs. 9,45,786 and it was added as deemed gift under s. 4.

7. Insofar as the India Motor Parts and Accessories Ltd. is concerned, it was submitted that the balance sheet as on 31st March, 1972 has to be

taken, as stated by the High Court in CGT vs. Prema Srinivasan (supra). The GTO has taken into account the profits earned during the 10 months

upto 31st January, 1973 into consideration and the average profits for five years ending 31st March, 1972 at Rs. 2,96,000. On this basis, the break up value per share was worked out at Rs. 139. Since the Tribunal has allowed 30% discount in the case of T. V. Sundaram Iyengar & Sons

Ltd., and there are similar restrictive clauses in this case also, a similar discount at 30% was granted, which would result in the value coming down

to Rs. 97.03 per share. As the sale price was Rs. 109.50, there is no undervaluation in this case, according to the Tribunal.

8. In the case of Sundaram Pvt. Ltd., though the sale was after the end of accounting year 31st March, 1972, the balance sheet as at 31st March,

1972 had not been published on the date of sale, therefore balance sheet as at 31st March, 1971 was taken into consideration. The company did

not declare any dividend during four years ending 31st March, 1968 to 31st March, 1971. Since this was a private limited company and there

were restrictive clauses as respects the transfer of shares, 30% discount should be allowed by the Tribunal, even if the balance sheet as at 31st

March, 1972 is taken into account and the discount at 30% is given to the figure Rs. 189.81 arrived at by the GTO, the resultant figure would be

Rs. 127, which was lower than the sale price at Rs. 128.

9. As regards Sundaram Fasteners Ltd., there are also restrictive clauses as in the case of the other companies. Since the sale took place on 14th

February, 1974, the balance sheet as at 31st March, 1973 has to be taken. The value of 7 lakh shares on the basis of the balance sheet as at 31st

March, 1973 as worked out by the assessee, at the time of sale was Rs. 55,84,000 and the average profit during the five years ending 31st

March, 1969 to 31st March, 1973 was Rs. 2.30 lakhs. On this basis, the value per share was worked out at Rs. 8.32. This company had not

declared dividends for six years. Therefore, the Tribunal held that at the time of sale, there was no case of any addition on account of deemed gift.

10. Learned counsel for the Department would submit that the balance sheets drawn after the date of sale, were the nearer ones to the dates of

sale and therefore, on the basis of those balance sheets, the fair market value of the shares should be ascertained. However, the learned counsel

for the assessee would contend that only the balance sheets, drawn up immediately preceding the date of sale should be taken into consideration,

even though they are not as nearer as that of the balance sheets drawn up after the date of the respective sales.

11. In Bharat Hari Singhania vs. CWT (supra), the Supreme Court held that r. 1D is mandatory in nature and Expln. I thereto is provided to meet

the situation where the date of the balance sheet and the valuation date of the assessee do not coincide.

12. While considering r. 1D of the Rules to a case arising out of GT Act, 1958 Sch. II, this Court in Commissioner of Gift-tax Vs. Gopal

Srinivasan, held that r. 1D is mandatory and in the cases where the date of the balance sheet and the valuation date of the assessee do not

coincide, Expln. I to r. 1D has to be applied whereunder in the cases where the date on which the balance sheet is drawn up does not coincide

with the valuation date of the assessee, the balance sheet drawn up on a date immediately preceding the valuation date shall be adopted as the

basis for working the rule and in yet another situation where both the above situations are absent, the balance sheet drawn up on a date

immediately after the valuation date shall be adopted as the basis and that would be the most reasonable thing to do. This view was taken by this

Court following the decision of the Supreme Court in Bharat Hari Singhania vs. CWT (supra).

13. As regards the applicability or otherwise of the Rules (WT Rules) to the proceedings arising under GT Act, in Controller of Estate Duty,

Mysore Vs. J. Krishna Murthy, the Mysore High Court pointed out that the method of valuation of unquoted shares prescribed under r. 1D of the

Rules (WT Rules) by WT (Amendment) Rules, 1967, dt. 6th October, 1967 mearly replaced the then existing circular of the CBDT issued under

Circular 3, WT of 1957 dt. 28th September, 1957. The Board circular again emphasised the well known method of valuation of the shares. It was

further found in that case that the principle of method of valuation of property, under s. 36 of the ED Act or under s. 7 of the WT Act 1957 or s. 6

of the GT Act, 1958 is the same. Therefore, the Mysore High Court pointed out that the adoption of the method of valuation prescribed under the

WT Act for the case arising under ED Act, could not be characterised as arbitrary. Therefore, in our opinion, what is applicable to the method of

valuation adopted under WT Act can equally be made applicable to gift tax purposes. Rule 1D prescribed a well known method of ascertaining

the value, which a property would fetch, if sold in the open market in respect of shares. In the present case, both the assessee and the Department followed the break up method in ascertaining the value of unquoted equity shares. Even though the balance sheet, which was drawn up immediately

preceding the date of sale of shares, the Tribunal took into consideration the profit earned from the date of drawing up of the balance sheet till the

date of sale. Therefore, the value was ascertained as on the date of sale by taking into account what the shares would have fetched if sold in the

open market on the date of sale. In view of the provisions contained in the Expln. I to r. 1D of the Rules and in the face of the decision of the

Supreme Court and of this Court, referred to supra, we hold that there is no infirmity in the order passed by the Tribunal in valuing the unquoted

equity shares by adapting the balance sheets, which were prepared prior to the date of sale.

14. Now, what remains to be considered is whether the Tribunal was correct in allowing the discount at 30% while arriving at the break up value

of the shares of the companies in question having regard to the restrictive clauses found in the articles of association of the companies, whose

shares were disposed of.

15. Insofar as Sundaram Pvt. Ltd. is concerned, the company has not declared any dividend during the four years ending 31st March, 1968; 31st

March, 1969; 31st March, 1970; and 31st March, 1971. Since this is a private limited company and having restrictive clauses relating to the

transfer of shares, the assessee required 30% discount. According to the Tribunal even if the balance sheet as at 31st March, 1972 is taken into

account and if the discount of 30% is given to the figures Rs. 189.81 arrived at by the GTO, the resultant figure would be Rs. 127 which is less

than the sale price of Rs. 128. In the case of India Motor Parts and Accessories Ltd., 30% discount was allowed as there was also a restrictive

clause in the Articles of Association and the Tribunal had allowed 30% discount in the case of T. V. Sundaram Iyengar & Sons Ltd., it was

pointed out by the Tribunal that the resultant figure would be Rs. 97.03 per share, while the sale price was Rs. 109.50. In the case of Sundaram

Fasteners Ltd., for the very same reasonings, the sale price was Rs. 6 while the figure arrived at was Rs. 5.82 per share. Considering the

aforementioned depressing factors like restriction on sale of share in the matter of private limited companies, non-declaration of dividends for 4 to

6 years, etc., the allowance of 30% towards discount was accepted by the Tribunal.

16. However, learned standing counsel for the Department submitted that in any event, the discount could not be more than 15% as per the

provisions of r. 1D of the Rules, which is mandatory in nature. According to learned counsel for the assessee, in view of the depressing factors,

referred to above, the granting of 30% discount cannot be said to be unreasonable. In the matter of ascertaining the value of unquoted equity

shares, it will be necessary to ascertain what the share of a private limited company would fetch, if sold in a hypothetical market, which may not

really exist.

17. In COMMISSIONER OF GIFT-TAX, TAMIL NADU-III Vs. S. VENU SRINIVASAN AND ANOTHER., , this Court has held that the

fact that a company is a private limited company and there is not the freedom to deal with the shares held in such a company will not affect the

question as to the possible value the shares would fetch had they been sold in the open market on the date of the gift. Even in such cases under r.

10(2) of the GT Rules, 1958, it should be assumed that the shares were capable of being sold freely in the open market and that there would be

purchasers for the same. Therefore, it will be necessary to ascertain what the shares of a private limited company would fetch if sold in a

hypothetical market which may not really exist. However, the value the shares of a private limited company would fetch in the open market as

ascertained disregarding the restrictions as to sale will have to be reduced because in reality the shares would not fetch that much of money when

transferred because the shares in a private limited company are not easily transferable and hence, cannot be treated to be on a par more or less

with money that can be handed over quickly from one person to another or other commodities which are readily saleable"".

18. In CGT vs. Prema Srinivasan (supra), it has been held that ""for valuing a property for purposes of gift-tax, the question always is what the

property would have fetched if sold in the open market on the date on which the gift was made. The search must always be to find out the market

value of the property gifted on the date of the gift. Since the date of the gift is important, the state of affairs as on that date will have to be ascertained. Even in the case of private limited company, it has to be assumed that the sale of the shares would take place in the open market and

the market value as on the date of gift will have to be ascertained. Changes which might have happened after the shares were valued in the balance

sheets of the company will and can and should be taken note of by the GTO. There will be no error if the position as on the date of the gift is

ascertained assuming that the real position is ascertainable"".

19. In the matter of allowing discount as per the provisions of r. 1D of the Rules, it says that discount can be given at 15%. There is also a table

provided under r. 1D and according to it, if the dividend has not been paid for three years, the market value of each unquoted equity share shall be

82-1/2%; if the dividend was not declared for four years, the market value shall be 80%, for five years 77-1/2% and for six years and above, it

shall be 75%. It means that discount can be given to the extent of 25% where the dividend was not paid for a period of six years or more.

20. Considering the fact that the profit for each share was worked out upto the date of sale and the restrictive clauses contained in the articles of

association of the companies in question, the Tribunal thought it fit to grant a discount at 30% which cannot at all be said to be unreasonable. Since

this aspect had been considered on the basis of the facts available on record, we do not want to go deep into this matter. In that view of the

matter, we answer both the questions referred to us in the affirmative and against the Department. No costs.