

(1991) 03 KL CK 0021

In the High Court Of Kerala

Case No : Income-tax Reference No"s. 311 to 315 of 1982

Commissioner of Income Tax

APPELLANT

Vs

Antony Mendez

RESPONDENT

Date of Decision : 14-03-1991

Acts Referred:

Wealth Tax Act, 1957 — Section 46, 46(1), 46(2), 7, 7(1)
Wealth Tax Rules, 1957 — Rule 1D

Citation : (1991) 2 ILR (Ker) 887 : (1991) 191 ITR 346

Hon'ble Judges : T.L. Viswanatha Iyer, J;K.S. Paripoornan, J;K.A. Nayar, J

Bench : Full Bench

Advocate : P.K.R. Menon and N.R.K. Nair, for the Appellant; P.G.K. Wariyer, for the Respondent

Judgement

T.L. Viswanatha Iyer, J.—The Income Tax Appellate Tribunal, Cochin Bench, has referred the following question of law to this court u/s 27(1) of the Wealth-tax Act, 1957 ("the Act" for short) :

"Whether, on the facts and in the circumstances of the case and having regard to the mandatory provisions of Rule 1D, the Tribunal is justified in interfering with the valuation of shares by the Wealth-tax Officer ?"

2. When the reference came up before the Division Bench of two of us, namely, Paripoornan and K. A. Nayar JJ., it was felt that the question referred did not truly reflect the matter in controversy and, accordingly, this court amended the question referred and formulated the following question of law as the real question arising for decision :

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in interfering with the valuation of shares made by the Wealth-tax Officer ?"

3. In view of the sharp conflict of judicial opinion that prevailed on the sole question arising for consideration as to whether Rule 1D of the Wealth-tax Rules

("the Rules") was mandatory or directory, the matter was referred for decision by a Full Bench of this court. The cases have, accordingly, come up before us for consideration.

4. We shall briefly refer to the facts of the case before going into the controversy. The assessee, the respondent is a non-resident to whom 1,962 shares of the face value of Rs. 100 each had been allotted in a private limited company, M/s. Company De Mendes (P.) Ltd. This allotment was irregular as prior approval of the Reserve Bank of India had not been obtained for the allotment to the non-resident. The Reserve Bank of India, therefore, objected to the allotment, as early as in 1965, and refused to give ex post facto approval for the registration of the shares in the name of the assessee. The company was directed to "arrange to have the defect rectified" under advice to the bank.

5. Since the defect notified was not rectified, the bank reminded the company in March 1966, stating that if no reply was received about the rectification of the defect within 15 days, the bank will be constrained to take further action against the company under the Foreign Exchange Regulation Act, 1947.

6. In the light of the irregularity in the allotment and the direction from the Reserve Bank, it became necessary for the assessee to sell the shares at any cost to a resident, to avert criminal proceedings and other complications. The company itself was in the meanwhile suffering losses continuously and no dividend had been declared till March 31, 1977. The assessee, eventually, sold the shares on August 17, 1974, at the face value of Rs. 100 to some of the other shareholders of the company. The Reserve Bank had granted him permission to sell the shares at that rate with the specific condition that the sale proceeds will be credited to a non-resident account to be opened in his name with an authorised dealer and that no portion of the sale proceeds or any income accruing therefrom shall be allowed to be repatriated abroad.

7. In the assessments to tax under the Act for the years 1970-71 to 1974-75, the Wealth-tax Officer did not accept the assessee's return of value of the shares at Rs. 100 per share. On the other hand, he applied Rule 1D of the Rules and valued the shares at Rs. 180 per share, adopting the "break up value" method of valuation. The orders of assessment, annexures A1 to A5, were, accordingly, completed on that basis.

8. The assessee challenged the assessments in appeal. He contended that, on the facts mentioned above and the direction contained in the Reserve Bank's permission to sell, he could not have sold the shares at more than Rs. 100 per share and, therefore, their market value in his hands could only be Rs. 100 per share and this should be accepted as the market value instead of the break up value adopted by the Wealth-tax Officer. The Appellate Assistant Commissioner did not accept this contention as, in his view, the Reserve Bank of India had not imposed any restriction on the sale price. According to him, the assessee had himself offered to sell at Rs. 100 per share and the Reserve Bank had just

accepted it. Therefore, the Wealth-tax Officer was justified in adopting the break up value of the shares as the market value. The assessments were, accordingly, confirmed in so far as they related to the market value of the 1962 shares.

9. The assessee went up in second appeal to the Appellate Tribunal, who by the order annexure C dated June 6, 1981, allowed the appeals. The Revenue contended that, for unquoted shares like these, the break up method was the only method of valuation prescribed under the Rules. The Tribunal disagreed with this contention and followed the decision of the High Court of Bombay in *Smt. Kusumben D. Mahadevia V. N. C. Upadhyaya and Others* *Kusumben D. Mahadevia Vs. Commissioner of Wealth-tax, Bombay City-I*, to hold that it was not mandatory to follow Rule 1D and that, in appropriate cases, deviation from the method envisaged in that rule was permissible. The Tribunal then went on to consider the matter on merits and came to the conclusion that it took about nine years from 1965 to 1974 for the assessee to find a willing purchaser, and that, for the reasons stated, the face value adopted by the assessee for the shares in question reflected their real market value. The appeals were thus allowed.

10. It is on these facts that the question of law was referred and the question was reframed by this court as stated in paragraph 1 hereinabove. "

11. In drawing up the statement of the case, the Tribunal took note of the fact that this court had, in *COMMISSIONER OF WEALTH-TAX Vs. MAMMAN VARGHESE and OTHERS.*, , held that Rule 1D was mandatory. In the circumstances the Tribunal felt that a question of law arose for consideration in the case and, accordingly, referred the question u/s 27(1).

12. The respective contentions of the parties may be noted before we proceed to discuss the matter. The company whose shares are involved in this case is a private limited company. The shares are not quoted in the stock exchange. According to the Revenue, the only permissible mode of valuation of such shares is that laid down in Rule 1D of the Rules and any deviation therefrom is not permitted in law. The rule is mandatory.

13. On the other hand, the assessee contends that Rule 1D is not mandatory. It is open to the assessee to prove the real market value of the shares and to have that value adopted for purposes of assessment to wealth-tax. Rule 1D indicates only the mode of assessing the market value in cases where no material is available to determine the market value otherwise. Evidence was available in this case to determine the market value of the shares. The Tribunal has, on this evidence, found, as a fact, that the real market value of the shares was only Rs. 100 per share. The assessments could, therefore, have been completed only on that basis.

14. We may first advert to the relevant provisions of the Act. The Act in question is one to provide for the levy of wealth-tax. Section 3 is the charging section. It provides that, subject to the other provisions contained in the Act, there shall be charged for every assessment year commencing on and from the first day of

April 1957, a tax (referred to as wealth-tax) in respect of the net wealth on the corresponding valuation date of every individual or Hindu undivided family at the rates specified in the Schedule. The charge is, therefore, made with reference to the net wealth which is defined in Section 2(m) as meaning the amount by which the aggregate value computed in accordance with the provisions of the Act of all assets, wherever located, belonging to the assessee on the valuation date, including assets required to be included in his net wealth as on that date under the Act is in excess of the aggregate value of all the debts owed by the assessee on the valuation date other than those enumerated in Sub-clauses (i) to (iii). Section 4 enumerates certain assets to be included in the net wealth of the assessee. Sections 5 and 6 categorise those assets which are exempted or excluded in the computation of the net wealth. Section 7 lays down the mode of determination of the value of assets. We shall quote Sub-section (1) which is relevant:

"7(1) Subject to any rules made in this behalf, the value of any asset, other than cash, for the purposes of this Act, shall be estimated to be the price which in the opinion of the Wealth-tax Officer it would fetch if sold in the open market on the valuation date."

15. Section 46 contains the rule-making power. It authorises the Central Board of Direct Taxes to make rules for carrying out the purposes of the Act. The relevant parts of the section, namely, Sub-section (1) and Clauses (a) and (f) of Sub-section (2) are extracted below :

"46(1) The Board may, by notification in the Official Gazette, make rules for carrying out the purposes of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, rules made under this section may provide for -

(a) the manner in which the market value of any asset may be determined ...

(f) any other matter which has to be, or may be, prescribed for the purposes of this Act."

16. No rules as envisaged by Section 7 had been framed in relation to the valuation of unquoted shares, till October 6, 1967, when Rules 1C and 1D were introduced. Rule 1C related to unquoted preference shares and Rule 1D, to unquoted equity shares of companies other than investment companies and managing agency companies. Rule 1D in so far as it is relevant for this case is quoted below :

"1D. Market value of unquoted equity shares of companies other than investment companies and managing agency companies.--The market value of an unquoted equity share of any company, other than an investment company or a managing agency company, shall be determined as follows :

The value of all the liabilities as shown in the balance-sheet of such company

shall be deducted from the value of all its assets shown in that balance-sheet. The net amount so arrived at shall be divided by the total amount of its paid-up equity share capital as shown in the balance-sheet. The resultant amount multiplied by the paid-up value of each equity share shall be the break-up value of each unquoted equity share. The market value of each such share shall be eighty five per cent. of the break-up value so determined.

Provided that where, in respect of any equity share, no dividend has been paid by such company continuously for not less than three accounting years ending on the valuation date, or in a case where the accounting year of that company does not end on the valuation date, for not less than three continuous accounting years ending on a date immediately before the valuation date the market value of such share shall be as indicated in the Table below:

THE TABLE

Number of accounting years ending on the valuation date or in a case where the accounting year does not end on the valuation date, the number of accounting years ending on a date immediately preceding the valuation date, for which no dividend has been paid. Market value

1

2

Three years 82½ per cent of the break up value of such share.

Four years 80 do.

Five years 77½ do

Six years and above 75 do"

17. The mode of valuation prescribed is that known as the break-up method of valuation. The Wealth-tax Officer has adopted this method in valuing the 1962 shares of the assessee. The contention of the Revenue is that it is obligatory for the officer to follow this method, because of Rule 1D, and that it is not open to him to fix the value of the shares in any other manner. Therefore, the question for consideration is whether Rule 1D is mandatory or directory.

18. It is now well established that the question whether a provision is mandatory or directory depends upon the intent of the Legislature and not upon the language in which the intent is clothed. The court must carefully get into the underlying idea of the provisions and ascertain the purpose to be achieved notwithstanding the text of the provision. The use of the word "shall" does not conclude the matter. The word is no doubt obligatory in its ordinary import But it need not be given that connotation in each and every case, and a provision can be interpreted as directory despite the use of the word "shall", with reference to the context, the subject-matter and the object of the statute in question (See Rubber House Vs. Excelsior Needle Industries Pvt. Ltd.,). In short, the

construction ultimately depends on the provision itself keeping in view the object, design, purpose and scope of the enactment and the context in which the word "shall" has been used.

19. In COMMISSIONER OF WEALTH-TAX Vs. MAMMAN VARGHESE and OTHERS., , a Division Bench of this court held that Rule 1D was imperative and had to be followed for the valuation of unquoted equity shares. The Bench reached this conclusion based on the use of the word "shall" in Section 7 and Rule 1D together with the further fact that the section itself opened with the words, "subject to any rules made in this behalf". This is what the Division Bench stated (p. 355) :

"The section itself opens with the words "subject to any rules made in this behalf, thereby bringing out the paramountcy of the rules. The section then proceeds to use imperative language by providing that the value of any asset "shall" be estimated to be the price which, in the opinion of the Wealth-tax Officer, it would fetch if sold in the open market on the valuation date. Turning to the rule again, we notice the imperativeness of the provision in the direction that the value of an unquoted equity share "shall" be determined.

In the context and from the purport of the section and the rule, we do not see any warrant or justification for construing the expression "shall" in the section and the rule as "may" or in understanding this provision as directory and not mandatory ..."

20. In doing so, this court followed the decisions of the High Court of Allahabad in Commissioner of Wealth-tax Vs. Sripat Singhania, and in Commissioner of Wealth-tax Vs. Padampat Singhania, , and chose to differ from the decision of the Madras High Court in K.M. Mammen Vs. Wealth-Tax Officer, City Circle-II (1) Madras, , a copy of which had been annexed as annexure D to the statement of the case. In the light of the decisions of the Allahabad High Court, the Bench did not also find its way to accepting the opinion expressed in Volume I of the Fifth Edition of Sampath Iyengar's Treatise on the Three New Taxes that Rule 1D should be understood as being directory and not mandatory.

21. The decision of this court had been rendered on November 14, 1979, though it was reported only much later in 1983 in the Income Tax Reports. This decision was applied by another Bench of this court, without any discussion, in the case, Mrs. Grace Collis and Others Vs. Commissioner of Wealth-tax, .

22. This court did not, at the time it rendered the decision in COMMISSIONER OF WEALTH-TAX Vs. MAMMAN VARGHESE and OTHERS., , have the advantage of seeing the decision of the High Court of Bombay in Smt. Kusumben D. Mahadevia V. N. C. Upadhyaya and Others Kusumben D. Mahadevia Vs. Commissioner of Wealth-tax, Bombay City-I, which, though rendered on February 21, 1979, was reported only in the year 1980. In that case, the High Court of Bombay had taken the view that Rule 1D was not mandatory, but only directory. The same view had been taken by the High Court of Madras in K.M. Mammen Vs. Wealth-

Tax Officer, City Circle-II (1) Madras, to which reference was made in dissent in COMMISSIONER OF WEALTH-TAX Vs. MAMMAN VARGHESE and OTHERS., . The High Court of Andhra Pradesh had occasion to deal with the matter recently with reference to the divergent opinions expressed by the various High Courts on the point in D. Renuka Vs. Commissioner of Wealth-tax, . The court observed that there was much to be stated in favour of either view, whether the rule was mandatory or directory, but the Bombay view was preferred for the reason that the view of the Allahabad and Kerala High Courts that it was mandatory brought about a situation unrelated to realties and it would be unjust to assesseees to adopt that view, particularly in the case of wealth-tax.

23. It is in this background that we have to consider whether Rule 1D is mandatory or directory.

24. Section 3 of the Act provides for the levy of tax in respect of the net wealth of the assessee. The normal procedure for fixing the value of the assets is laid down in Sub-section (1) of Section 7 which provides, subject to any rules made in that behalf, for the estimation of the value of an asset at the price which, in the opinion of the Wealth-tax Officer, it would fetch if sold in the open market. The section does not lay down any fiction regarding the value and it is left to the Wealth-tax Officer to estimate the same with reference to the price it would fetch in the open market on the valuation date. Since a precise or exact determination of that price on a future date may not be possible, it is left to the Wealth-tax Officer to form an opinion regarding the price. Of course, the opinion is not an arbitrary or unbridled one ; it should be one based on materials and on relevant facts and circumstances. But there is nothing in the language of Section 7(1) requiring the valuation of any particular asset to be done in a particular manner. What is contemplated is that the value determined should approximate to the market price on the valuation date.

25. The expression "subject to any rules made in this behalf" in Section 7(1) does not make the rules determinative of the mode of estimation of the value. The rules are intended to carry out the purposes of the Act. The rules can only guide the Wealth-tax Officer in forming his opinion on the value of the asset as contemplated by Section 7(1), namely, the market price as on the valuation date. We cannot postulate that Parliament totally delegated the function of fixing the open market price to the decision of the executive rule-making authority to be done in the manner chosen by it. The rules can at best lay down only guidelines to enable the Wealth-tax Officer to determine the value of the asset, in the performance of his functions u/s 7(1). When the substantive provision in Section 7(1) itself has not created any mandatory or fictional mode of valuing the asset, we cannot read the rules as imposing, for fixation of the market price, such a mandate or creating a fiction. The rule-making power is itself indicative of the position that no imperative rules are to be framed and that, on the other hand, only guidelines which the assessing authority may follow are to be laid down. This is evident from Sub-clause (a) of Sub-section (2) of Section 46 which

is illustrative of the general power conferred by Sub-section (1) of the section. Sub-section (2) provides that the rules framed u/s 46(1) may provide for the manner in which the market value of the asset may be determined. The use of the word "may" is indicative of the fact that the Legislature has only authorised the laying down of guidelines for the determination of the value of the asset, and not rules enjoining strict compliance with them in the matter of valuation. This is quite in consonance with the spirit and scheme of Section 7(1) vesting in the Wealth-tax Officer the right to form his opinion regarding the open market price and to fix the value of the asset based thereon.

26. It is true that Section 46(2)(a) is only illustrative of the general provision u/s 46(1), but Section 46(1) itself does not authorise the framing of any imperative or binding rule, doing away with the prescriptions of Section 7(1). When the illustrative power is specific that the executive rule-making authority is only given power to specify the mode in which the value may be determined, it is not for the rule-making authority to make a rule which is imperative in its terms. If Rule 1D is to be treated as mandatory and imperative, that will in effect go beyond the purview of Section 46(2)(a).

27. What is provided in Rule 1D is the determination of the value of unquoted equity shares by the break up value method. This method is one employed to arrive at the value of the shares at a time when the company is ripe for winding up. The break up value of a share, as on liquidation, hardly enters into consideration between a seller and a purchaser, where the shares are of a going concern. The accountancy principles on the point have been referred to and discussed at length by the Bombay High Court "in Smt. Kusumben D. Mahadevia V. N. C. Upadhyaya and Others Kusumben D. Mahadevia Vs. Commissioner of Wealth-tax, Bombay City-I, The Supreme Court had occasion to deal with the various modes of valuation of shares, including the break up value method, in the decision in Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc., . After enumerating the factors which are taken into consideration and which affect the value of shares and after discussing the matters which enter into the reckoning when a person wishes to buy or sell shares, the court observed (p. 629) :

"From what we have stated, among the factors which govern the consideration of the buyer and the seller where the one desires to purchase and the other wishes to sell, the factor of break-up value of a share as on liquidation hardly enters into consideration where the shares are of a going concern. The basic yield method in cases where shares are quoted and transactions take place on the share market may not be different but where shares are not quoted, it is in these latter cases the yield must be determined after taking into account various factors to which a reference has been made earlier."

28. In Commissioner of Gift Tax, Bombay Vs. Smt. Kusumben D. Mahadevia, , the Supreme Court again went into the question of valuation of shares in great detail. The shares concerned were of a private limited company, which was a

going concern. The assessee pleaded that they should be valued by applying the profit-earning method of valuation but the Gift-tax and Wealth-tax Officers chose to value them at much higher figures, adopting the break up value method. The Supreme Court considered the matter in detail and held (pp. 45, 46) :

"But where the shares in a public limited company are not quoted on the stock exchange or the shares are in a private limited company the proper method of valuation to be adopted would be the profit-earning method in the case of a company which is a going concern and whose shares are not quoted on the stock exchange, the profits which the company has been making and should be capable of making or, in other words, the profit-earning capacity of the company would ordinarily determine the value of the shares The break-up method would not be appropriate for valuation of shares of a company which is a going concern, because as pointed out by the court in Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc., , "among the factors which govern the consideration of the buyer and the seller where the one desires to purchase and the other wishes to sell, the factor of break-up value of a share as on liquidation hardly enters into consideration where the shares are of a going concern". It is only where a company is ripe for winding up or the situation is such that the fluctuations of profits and uncertainty of conditions at the date of valuation prevent any reasonable estimation of the profit-earning capacity of the company, that the valuation by the break-up method would be justified."

29. Having stated so, the court frowned upon the Revenue's advocacy of a combination of the two methods, the profit-earning and the break-up value methods, as not valid and as not having any sanction by any judicial or other authority.

30. The Supreme Court has thus categorically ruled that the break-up value method is appropriate generally only in the case of a company which is ripe for winding up. When this be the position, regarding the break-up value method, we cannot impute the rule-making authority with any intention to enjoin application of such a method appropriate to a company ripe for winding up to the valuation of shares of a going concern. If mandatoriness is to be attributed to Rule 1D, the position will be that a method of valuation applicable only to a specified situation may well be applied to all other situations. We are not inclined to bring about such a result which, as the Supreme Court held, is not sanctioned by any judicial or other authority, by reading Rule 1D as mandatory.

31. For all these reasons, we are of the view that Rule 1D is not mandatory and that, on the other hand, it is only directory, providing guidelines to the Wealth-tax Officer to arrive at the value of unquoted shares when there is no evidence or material available to determine the open market price of the shares on the valuation date. As we have pointed out earlier the decisions in Smt. Kusumben D. Mahadevia V. N. C. Upadhy and Others Kusumben D. Mahadevia Vs. Commissioner of Wealth-tax, Bombay City-I, of the Bombay High Court and in K.M. Mammen Vs. Wealth-Tax Officer, City Circle-II (1) Madras, of the Madras

High Court have taken this view which we have taken. For the reasons stated by us, we are not in a position to agree with the view taken in the various Allahabad decisions : Commissioner of Wealth-tax Vs. Laxmipat Singhania, , Commissioner of Wealth-tax Vs. Sripat Singhania, , Commissioner of Wealth-tax Vs. Padampat Singhania, and Bharat Hari Singhania Vs. Commissioner of Wealth-tax, , or in the decisions of this court in COMMISSIONER OF WEALTH-TAX Vs. MAMMAN VARGHESE and OTHERS., and Mrs. Grace Collis and Others Vs. Commissioner of Wealth-tax, . The use of the word "shall" in Rule 1D by itself is insufficient to make it mandatory when the context, the purpose and the object of the rule point to the contrary.

32. Any other view will make Rule 1D beyond the scope of the power u/s 46(2) (a). It will also be oppressive and lead to unjust results as pointed out by the Andhra Pradesh High Court in D. Renuka Vs. Commissioner of Wealth-tax, . A court should be loathe to place a construction which will lead to such results. We are of the opinion that the provisions of Section 7(1), Section 46 and Rule 1D do not oblige us to read the rule as mandating only one method of valuation of the unquoted shares, barring every other mode of valuation.

33. Counsel for the Revenue placed reliance on the decisions in Punjab Sikh Regular Motor Service, Moudhapara Vs. The Regional Transport Authority, Raipur and Another, and Joginder Singh v. Deputy Custodian-General of Evacuee Property AIR 1967 SC 145, cases dealing respectively with the provisions of the Motor Vehicles Act and Administration of Evacuee Property Act to contend that when the power under a statutory provision is made subject to rules framed under the Act, the rules must govern. But we do not find any such general proposition being laid down in these two decisions. They do not, therefore, advance the case of the Revenue.

34. The Appellate Tribunal was right in setting aside the orders of the assessing authority and the Appellate Assistant Commissioner and in upholding the assessee's contention regarding the value of the shares in question. We, therefore, answer the question refrained by this court in the affirmative, that is, in favour of the assessee and against the Revenue.

35. A copy of this judgment will be forwarded to the Registrar of the Income Tax Appellate Tribunal, Cochin Bench, for compliance.