

(1978) 04 CAL CK 0076
In the Calcutta High Court
Case No : Matter No. 377 of 1969

Commissioner of Wealth Tax

APPELLANT

Vs

Bejoy Kumar Karnani and Others

RESPONDENT

Date of Decision : 06-04-1978

Acts Referred:

Wealth Tax Act, 1957 — Section 7

Citation : (1979) 117 ITR 543

Hon'ble Judges : Dipak Kumar Sen, J;C.K. Banerji, J

Bench : Division Bench

Advocate : B.L. Pal and Ajit Sengupta, for the Appellant;R.N. Bajoria and Dilip Kumar Dhar, for the Respondent

Judgement

Sen, J.—The facts found and/or admitted in this reference at the instance of the Commissioner of Wealth-tax, West Bengal-III, are shortly as follows : Messrs. Bejoy Kumar Karnani and others, the assessee, a HUF, was assessed to wealth-tax for the assessment years 1957-58 to 1961-62, the relevant valuation dates being 31st March of each of the years from 1957 to 1961.

2. At the relevant period, the assessee held a number of shares in Karnani Properties Ltd. and Karnani Investment Pvt. Ltd. The WTO, following an order of the Tribunal in the wealth-tax assessment of Bejoy Kumar Karnani (individual), estimated the value of these shares by the method known as "break-up value" method. The shares of Karnani Properties Ltd. were accordingly valued at Rs. 6 per share for the assessment years 1957-58 and 1958-59 and at Rs. 6.23, Rs. 6.18 and Rs. 6.18, respectively, for the other assessment years, i.e., 1959-60, 1960-61 and 1961-62.

3. The shares of Karnani Investment Pvt. Ltd. had to be valued for the assessment years 1959-60, 1960-61 and 1961-62. Again following the "break-up value" method, the WTO estimated the value of these shares at Rs. 12 per share for the assessment years 1959-60 and 1960-61 and at Rs. 10.83 for the assessment year 1961-62.

4. In appeals preferred by the assessee, objecting to the valuation estimated as aforesaid, the AAC upheld the valuation as made by the WTO.

5. The assessee went up to the Tribunal on further appeals. Following, inter alia, an earlier order in the case of Balbhadradass Bangur in Wealth-tax Appeals Nos. 1199 to 1202 and Nos. 1231 to 1234 all of 1964-65, the Tribunal accepted the principle that unquoted shares of an investment company should be valued primarily on the basis of its dividend earning capacity.

6. In estimating the value of the shares of Karnani Properties Ltd., the Tribunal first considered the value of the quoted shares of other property holding companies and in particular those of Hindustan Building Society Ltd. and Messrs. Sahu Properties Ltd. for the purposes of comparison. It was found that by reason of the rate of dividend declared, the quoted market value of the shares in the said companies were at all material times lower than their break-up value. In two years when no dividend was declared, the shares of the Hindustan Building Society Ltd. were quoted at 50% and 40% of their par value.

7. The Tribunal next considered the profit yielding capacity of Karnani Properties Ltd. Ignoring the commission and allowances paid to the managing director the Tribunal computed the average net profits after payment of taxes to be Rs. 92,000, Rs. 72,000, Rs. 50,000, Rs. 43,000 and Rs. 8,000, respectively, for the assessment years 1957-58 to 1961-62. Accordingly, the net earning from the shares of this company was held to be about 3%. The Tribunal took into account that the rental income of the said company was affected by reason of the existence of a number of old tenants in the properties. The Tribunal also took into account that the value of the land belonging to the company had appreciated though not reflected in its balance-sheet. The Tribunal held that the shares of this company were more valuable than an ordinary share, yielding return of only 3%, and, accordingly, valued the same at 50% of par value, i.e., Rs. 2.50 per share.

8. In valuing the shares of Karnani Investment Pvt. Ltd., which was incorporated in 1958, the Tribunal noted that in the year ending the 31st March, 1959, after providing for director's remuneration of Rs. 11,250 and writing off preliminary expenses of Rs. 1,797 there was a net book loss of Rs. 2,043. By adding back the said amounts of remuneration and expenses, the Tribunal computed the real profits of the company to be Rs. 11,000. A comparable figure was estimated for the year ended 31st March, 1960, and for the year ended 31st March, 1961, real profit was estimated on a similar basis at slightly over Rs. 10,000. The Tribunal held that though profits were low by taking into account the future prospects of this newly floated company, the value of its shares should be estimated at 50% of the par value, i.e., Rs. 5 per share.

9. At the instance of the CWT, West Bengal-III, Calcutta, the following question has been referred u/s 27(1) of the W.T. Act, 1957, as a question of law arising from the order of the Tribunal:

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that for the purpose of Section 7(1) of the Wealth-tax Act, 1957, the value of unquoted shares of (1) Karnani Properties Ltd., and (2) Karnani Investments Private Ltd. as on the relevant valuation dates, should be determined on the basis of the average earning capacity of the shares ?"

10. At the hearing, Mr. B. L. Pal, learned counsel for the revenue, has drawn our attention to a decision of the Supreme Court in Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc., , for the following observations in the judgment (pp. 628, 634).

"Leaving aside any distress sales, the factors which in our view are likely to determine the fixation of a share on any particular day or at any particular time is, firstly, the profit earning capacity of the company on a reasonable commercial basis ; secondly, its capacity to maintain those profits or a reasonable return for the capital invested, and in special cases such as investment companies, the asset-backings, the prospects of capitalisation of its earning in the shape of declaration of bonus shares or where the company is financially and commercially sound, the prospects of issue of further capital where the existing shareholders have a right to apply for and obtain them at a certain price which is generally less than the market value, offering an increased yield on his investment, on the assumption that the company will be able to maintain the same rate or at least increase the aggregate payment of dividends on the increased capital (page 628). The yield method is the generally applicable method while the break-up method is the one resorted to in exceptional circumstances or where the company is ripe for liquidation but none the less is one of the methods." (page 634).

11. Mr. Pal drew our attention to a chart printed in the paper book at pages 84-85. From the figures entered in this chart, Mr. Pal contended that Karnani Properties Ltd. had no yielding capacity whatsoever from the years 1958-59 to 1961-62.

12. On the basis of the above Mr. Pal submitted that the shares in the instant case, belonging to investment companies, one of which had no yield whatsoever at the relevant time, therefore, fell within the category of special eases, and/or came within the exceptional circumstances and the break-up method had to be adopted for their valuation.

13. Mr. R. N. Bajoria, learned counsel for the assessee, has contended on the other hand, that the judgment of the Supreme Court in Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc., if read in its entirety supported the case of the assessee and not that of the revenue.

14. On the passage at page 628 of the report of the said judgment cited by Mr. Pal, Mr. Bajoria submitted that the Supreme Court had laid down -- therein the various factors which were likely to determine the value of the share of a company at any particular time. The main factors were, first, the profit earning

capacity of the company and second, the company's capacity to maintain such profits in future. It is only in determining the capacity of a company to maintain its profits and thus secure a reasonable return for capital invested, that the asset-backings of an investment company had to be looked into. He submitted that it was not laid down by the Supreme Court that in valuing the shares of an investment company, the profit earning capacity of the company should be ignored entirely and break-up method followed.

15. In support of this contention, Mr. Bajoria drew our attention to further observations of the Supreme Court in the same decision as follows (pp. 629, 630, 633):

"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 as to which a reference has been made earlier.....

But where a person holds shares in a company which is making losses and where it does not justify a declaration of dividends even from reserves as a temporary boost or where there is a possibility of its capital structure being affected or if that state of depression continues, in other words, the company is ripe for liquidation, the valuation may well be the break-up value of the shares;.....

An examination of the various aspects of valuation of shares in a limited company would lead us to the following conclusion :

(1) Where the shares in a public limited company are quoted on the stock exchange and there are dealings in them, the price prevailing on the valuation date is the value of the shares.

(2) Where the shares are of a public limited company which are not quoted on a stock exchange or of a private limited company the value is determined by reference to the dividends if any, reflecting the profit-earning capacity on a reasonable commercial basis. But, where they do not, then the amount of yield on that basis will determine the value of the shares. In other words, the profits which the company has been making and should be making will ordinarily determine the value. The dividend and earning method or yield method are not mutually exclusive ; both should help in ascertaining the profit earning capacity as indicated above. If the results of the two methods differ, an intermediate figure may have to be computed by adjustment of unreasonable expenses and adopting a reasonable proportion of profits.

(3) In the case of a private limited company also where the expenses are incurred out of all proportion of the commercial venture, they will be added back

to the profits of the company in computing the yield. In such companies the restriction on share transfers will also be taken into consideration as earlier indicated in arriving at a valuation.

(4) Where the dividend yield and earning method break down by reason of the company's inability to earn profits and declare dividends, if the set-back is temporary then it is perhaps possible to take the estimate of the value of the shares before set-back and discount it by a percentage corresponding to the proportionate fall in the price of quoted shares of companies which have suffered similar reverses.

(5) Where the company is ripe for winding up then the break-up value method determines what would be realised by that process.

(6) As in *Attorney-General of Ceylon v. Mackie* [1952] 2 All ER 775 a valuation by reference to the assets would be justified where, as in that case, the fluctuation of profits and uncertainty of the conditions at the date of the valuation prevented any reasonable estimation of prospective profits and dividends.

In setting out the above principles, we have not tried to lay down any hard and fast rule because ultimately the facts and circumstances of each case, the nature of the business, the prospects of profitability and such other considerations will have to be taken into account as will be applicable to the facts of each case. But, one thing is clear, the market value, unless in exceptional circumstances to which we have referred, cannot be determined on the hypothesis that because in a private limited company one holder can bring it into liquidation, it should be valued as on liquidation by the break-up, method. The yield method is the generally applicable method while the break-up method is the one resorted to in exceptional circumstances or where the company is ripe for liquidation but none the less is one of the methods." (page 633).

16. The submissions of Mr. Bajoria are not without substance. From the observations of the Supreme Court it appears to us that the break-up method is to be followed only in exceptional circumstances, e.g., where the company is ripe for liquidation ; not that the said method is to be applied to a particular type of company, e.g., an investment company. Generally, asset-backing in an investment company is no doubt an important factor, but it is only important for the purpose of determining if an investment company, by reason of its assets can be expected to yield consistent returns on the capital invested and not for the purpose of valuation of the shares of the company by taking the break-up value of the assets.

17. It is nobody's case that the companies in question were ripe for liquidation at the relevant time or that they were in such a condition that there would be little or no expectation of yield from or earning by them in future.

18. The Tribunal has specifically computed the real profits earned by the said two companies. These findings are not challenged. The Tribunal has nowhere referred

to the chart printed in the paper book relied on by Mr. Pal. It is not known who has prepared this chart or if the figures therein are correct, ex facie, the percentage of yielding capacity has been calculated in the chart on the basis of average annual net profit and not on actual profits. For the said reasons, the purported chart is of little significance in this reference.

19. We find that in arriving at the value of the shares, the Tribunal has taken into account all relevant factors as specified by the Supreme Court, viz., the yield, the assets, the potentiality and also the quoted value of shares in similar companies. Such valuation, in our opinion, is not in any way erroneous.

20. For the reasons stated above, we answer the question in the affirmative and in favour of the assessee. In the facts and circumstances of this case, there will be no order as to costs.

C. K. Banerji, J.

21. I agree.