

(1972) 10 KAR CK 0015
In the Karnataka High Court
Case No : T.R.C. No. 3 of 1971

Controller of Estate Duty, Mysore

APPELLANT

Vs

J. Krishna Murthy

RESPONDENT

Date of Decision : 05-10-1972

Acts Referred:

Estate Duty Act, 1953 — Section 36, 64 (1)
Wealth Tax Act, 1957 — Section 7
Wealth Tax Amendment Rules, 1967 — Rule 1D

Citation : (1974) 96 ITR 87

Hon'ble Judges : Mohammad Sharif, J;G.K. Govind Bhat, J

Bench : Division Bench

Advocate : S.R. Rajasekhara Murthy, for the Appellant; G. Sarangan, for the Respondent

Judgement

Govinda Bhat, J.—u/s 64(1) of the Estate Duty Act, 1953 (hereinafter called "the Act"), the Appellate Tribunal has stated a case and referred the following question for the opinion of this court :

"When, for the Wealth-tax Act, valuation of unquoted shares as on March 31, 1967, has to be done in accordance with the Wealth-tax Amendment Rules, 1967, taking the last published balance-sheet as on December 31, 1966, as the basis, whether the Tribunal is right in placing the same value as on September 11, 1967, the date of the death of the deceased purpose of estate duty assessment resulting in non-consideration of other items not covered by the Wealth-tax Rules going into the determination of the value of shares for estate duty purpose ?"

2. Learned counsel on both sides submitted that the question as framed is not satisfactory and that the same may be recast. As agreed to by the parties, we recast the question thus :

"Whether there was material for the Appellate Tribunal to determine the value of the shares at Rs. 1,69,020 ?"

3. One Mr. William died on September 11, 1967. At the time of his death he owned certain shares in Senapathy Whitley (Private) Ltd. The subscribed equity share capital of the said company was divided into 15,000 share of Rs. 100 each, of which the deceased held 1,000 shares. The accounting year of the company ends on 31st December and its balance-sheet as at December 31, 1966, had been published before the date of death. The shares held by the deceased as on March 31, 1967, the "valuation date" for the assessment year 1967-68, had been valued by the Wealth-tax Officer at Rs. 1,69,020 in accordance with section 7 of the Wealth-tax Act, 1957, read with rule 1D of the Wealth-tax Rules 1957. Subsequent to April 1, 1967, but before the date of death, the company had issued 6,000 bonus shares raising its subscribed equity share capital from Rs. 15,00,000 to Rs. 21,00,000. 400 bonus shares were issued to the deceased. Thus, on the date of death, the deceased held 1,400 ordinary shares of the face value of Rs. 100. The accountable person declared the value of the said shares at Rs. 1,52,600, the Assistant Controller of estate duty arrived at the value of Rs. 2,23,174 valuing each share at Rs. 159.41 which was arrived at in the following manner :

Rs. Value of net assets of the company 26,82,792 on the basis of its balance-sheet as at December 31, 1966 Estimated value of goodwill 12,33,800
----- Total 39,16,592 -----

4. Break-up value on the above basis was worked out at Rs. 186.50 a share. As the death took place nearly eight months after December 31, 1965, taking into account the expected dividend for the year 1967, he raised the value to Rs. 196.50 a share. Taking the normal yield from such companies at 8% he valued the share on yield basis at Rs. 250 a share, as it stood on December 31, 1966, before the declaration of bonus shares. He computed the value at Rs. 178.57 a share after the declaration of bonus share. Averaging the two values, one on the basis of break-up value and the other on yield basis. The Assistant Controller value the shares at Rs. 159.41 share.

5. Before the Appellate Controller, it was urged by the accountable person that the Assistant Controller was not justified in adding the value of goodwill to the value of the net assets of the company while determining the value according to the break-up method as rule 1D of the Wealth-tax Rules, 1957, referred to above does not require the goodwill value to be taken into account. The Appellate Controller did not decide that question. In this opinion the correct market value of the shares should have been ascertained with reference to the balance-sheet of the companies at December 31, 1967. After allowing 15% discount as provided under rule 1D, he valued the shares as Rs. 159.60 per share. As the said valuation approximated to the valuation adopted by the Assistant Controller and the difference being negligible, he confirmed the assessment made by the Assistant Controller.

6. The Appellate Tribunal held that the break-up value of the shares could have been determined only on the basis of published information and information

which the directors of the company would have given in answer to a reasonable question likely to be asked by any vendor-shareholder or intending purchaser and since the last published information in regard to the affairs of the company was as the December 31, 1966, the balance-sheet as at December 31, 1967, could not have been relied on for the purpose of arriving at the break-up value of the shares. The Tribunal accepting the valuation of the shares as determined for purpose of wealth-tax for the assessment year 1967-68, reduced the value of the shares to Rs. 1,69,020.

7. The question at issue in this case is the proper value of the share held by the deceased in Senapathy Whitley (Private) Ltd., for estate duty purposes. The shares must be valued as provided for by section 36 of the Act, sub-section (1) of section 36 states :

"The principles value of any property shall be estimated to be the price whgich, in the opinion of the Controller, it would fatch if sold in the open market at the time of the deceased"s death." The principles of valuation of property. Whether u/ s 36 of the Act or section 7 of the Wealth-tax-Act, 1957, or section 6 the Gift-tax Act, 1958, is the same. The valuer must decide what the highest bidder would have offered in the hypothetical sale in the open market, which the Act requires us to imagine, at the time of Mr. Whitley"s death on September 11, 1967. The sum which any bidder would offer must depend on what he knows or thinks he knows about the shares for which he bids.

8. In Lynall v. Inland Revenue Commissioners Mrs. Lynall died on May 21, 1962. At her death, she owned followed shares in Lineard, a private company. The account for the prevision year up to July 31, 1961, had been published. The account for the year up to July 31, 1963, when drawn up followed a substantial increase in profits. The question arose, whether unpublished information could be relied on for the purpose of valuation of the shares of the estate of Mrs. Lynall. Plowman J. held that in arriving at the open market value u/s 7(5) of the Finance Act, 1894, the court should only have regard to published information and information which the directors would in fact have given in answer to reasonable questions. That view was affirmed by the House of Lords.

9. Sri S. R. Rajasekhara Murthy for the department conceded, and in our opinion rightly, that for purpose of determining the break-up value of the shares as on September 11, 1967, the balance-sheet of the company asset December 31, 1967, cannot be looked into and that the information furnished by the company"s published balance-sheet as at December 31,1966, alone could be relied on. Learned counsel, however, urged that the Appellate Tribunal has not given any reason for not taking into account the estimated value of the goodwill of the company the company expected dividends for the year 1967 as was done by the Assistant Controller. He also argued that the mode of valuation prescribed by rule 1D of the Wealth-tax Rules is intended only for purposes of valuation under the Wealth-tax Act, and that for purpose of of valuation under the Act, valuation ought to be made in accordance with recognized modes of valuation of

shares since no rules have been made under the Act prescribing the manner in which the market value of unquoted equity shares may be determined.

10. Sri Sarangan for the accountable person submitted that the finding of the Appellate Tribunal is essentially one of fact, that the Tribunal has adopted one of the recognised methods of valuation, viz., the break-up method of valuation, which is also the method adopted by the Appellate Controller, that the Appellate Controller also did not take into account the value of goodwill of the company and, therefore, it cannot be contended that there was no material for the Tribunal to value the shares at Rs. 1,69,020.

11. Valuation of stocks and shares quoted on the stock exchange presents little difficulty; but valuation of unquoted shares has always presented considerable difficulty. In *Salvesen's Trustees v. Inland Revenue Commissioners*, a leading case on the subject, Lord Fleming pointed out the difficulty of estimating the value of shares in a company whose shares would not be bought and sold in the open market and with regard to which there had not been any sales on ordinary terms and said at page 392 :

"The problem can only be dealt with by considering all the relevant facts so far as known at the date of the testator's death, and by determining what a prudent investor, who knew these facts, might be expected to be willing to pay for the shares."

12. He then classified the relevant facts under four heads, viz., :-

(A) The history of the industry.

(B) The history of the company from its inception to the date of the death and particularly its position at that date.

(C) The prospects of the industry generally at that date and of the company in particular.

(D) The extent to which the restrictions in the articles might be expected to depreciate the value of the shares.

13. Heads (A) and (B) are of importance primarily as a means of estimating head (C).

14. Estimate of value of unquoted shares is done on the theoretical lines by comparison with the known prices of share which are quoted on the stock exchange where conditions approximating with those statutory hypothetical open market rate obtained (*Vide Dymond's Death Duties*, fourteenth edition, at page 577).

15. Investigations are made to arrive at two sets of figures, viz., (1) the rates of dividends and profits which may reasonably be expected in the future from the shares in questions, and (2) the dividend and profit yields which can in fact be obtained in the open market from quoted shares which are as nearly as possible

comparable with those being valued. From the figures thus arrived at by comparison with particular companies, a general indication of the expected yielded will emerge, on which the valuation of the share may be based : Vide Dymond's Death Duties. Fourteenth edition, at pages 584 and 585.

16. There is another method of valuation known as "break-up value" method i.e., the net amount which the shareholder would receive in the event of liquidation. In the estate duty cases involving valuation of unquoted shares, the practice in the United Kingdom is for the revenue and the accountable person to adduce evidence of expert share values who make estimation of the market value of the shares in question in accordance with the recognized of valuation. Valuation of property is an art rather than a precise science and as such the assistance of experts in the line is always necessary in order to arrive at a decision.

17. In India, estate duty came to be introduced by the enactment of the Act which was brought into force on October 15, 1953. No rules were made under the Act prescribing the manner in which there value of unquoted share may determined for purpose of estate duty. In the absence of such rules, the market value has to be determined in accordance with recognised methods of valuation.

18. On April 1, 1957, the Wealth-tax Act, 1957, came into force. The problem of valuation of unquoted arose under the said Act also. In exercise of the powers conferred by section 13 of the Wealth-tax Act, the Central Board of Direct Taxes issued Circular No. 3 WT. of 1957 dated September 28, 1957, containing instructions regarding valuation of unquoted shares. The method of valuation directed thereunder was the "break-up value". The said circular was replaced by rule 1D inserted in the Wealth-tax Rules, 1957, by the Wealth-tax (Amendment) Rules. 1967, issued on October 6, 1967. Rule 1D reads thus :

"1D. Market value of unquoted equity share of companies, other than investment companies and managing agency companies. - The market value of an unquoted equity share of any company. Other then 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 85 per cent. of the break-up value so determined... (Proviso omitted as unnecessary).

Explanation I. - For the purpose of this rule, "balance-sheet" in relation to any company, means the balance-sheet of such company as drawn up on the valuation date and where there is no such balance-sheet, the balance-sheet drawn up on a date immediately preceding the valuation date and, in the absence of both, the balance-sheet drawn up on a date immediately after the

valuation date.

Explanation II-For the purpose of this rule -

(i) The following amounts shown assets in the balance-sheet shall not be treated as assets, namely :- (a) Any amount paid as advance-tax u/s 18A of the Indian Income Tax Act, 1922 (11 of 1922); or u/s 210 of the Income Tax Act, 1961 (43 of 1961);

(b) any amount shown in the balance-sheet including the debit balance of the profit and loss account of the profit and loss appropriation account which does not represent the value of any asset;

(ii) The following amounts shown as liabilities in the balance-sheet shall not be treated as liability, namely :-

(a) the paid-up capital in respect of equity shares;

(b) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the valuation date at a general body meeting of the company :

(c) reserves, by whatever name called, other than those set apart towards depreciation;

(d) credit balance of the profit and loss account;

(e) any amount representing provision for taxation [other than the amount referred to in clause (i)(a) to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;

(f) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference share."

19. The Rules have been made in exercise of the power conferred by section 46(2)(a) of the Wealth-tax Act, 1957, which empowers the Board to provide for the manner in which the market value of any asset may be determined. The Rules have been laid before each House of Parliament.

20. Under its rule-making power, the Board cannot provided for any arbitrary manner of valuation of any asset. The method of valuation which may be prescribed shall be one of the recognised methods of valuation of assets."Breaks-up value" method being one of the recognised methods of valuation, the Board has prescribed that method for the purposes of valuation of unquoted shares under the Wealth-tax Act. Although the practice prevailing in the United kingdom, the United States of America, etc., requires the goodwill value of a company to be included for arriving at the net value of its assets, so far as India is concerned, the law as provided in rule 1D is that the "break-up value" method does not require the goodwill value of a company to be included.

21. We agree with the learned counsel for the revenue that rule 1D does not

govern the manner of valuation of shares for the purposes of estate duty, as already stated, there is no rule made under the Act providing for the manner of valuation of unquoted shares. In the absence of rules valuation for purpose of the Act has got to be made in accordance with recognised methods of valuation followed in India. The method or valuation prescribed by rule 1D of the Wealth-tax Rules, 1957, being the only statutorily recognised method of valuation of unquoted equity shares in this country, it would not be wrong to adopt that method of valuation for purpose of estate duty also, though the rule as such is inapplicable. The rule can be looked into only off the purpose of knowing the manner of break-up method of valuation which is one of the recognised methods of valuation.

22. As stated in the earlier part of this judgment, "the principal value of any property u/s 36 of the Act shall be estimated to be the price which, in the opinion of the Controller is would fetch if sold in the open market at the time of the assessee's death". It is the price which the property would fetch in the hypothetical sale in the open market. The same as the principal of valuation under the Wealth-tax Act and the Gift Tax Act. If unquoted shares are valued in accordance with rule 1D of the Wealth-tax Rules and that is the price which in the opinion of the Wealth-tax Officer they would fetch if sold in the open market on the "valuation date", it stands to reason that the same should be the value of the said shares for purposes of estate duty if the death takes place on the "valuation date" or near about that date. Let us suppose that the deceased had died on March 31, 1967, or a week thereafter. Then the shares held by the deceased on March 31, 1966, have to be valued at Rs. 1,69,020 under the Wealth-tax Act; the same shares have to be valued at Rs. 2,23,174 for estate duty if the argument on behalf of the department that the goodwill value of the company ought to be included in arriving at the break-up value is accepted as sound. Since under both the Acts, it is the price the shares would fetch if sold in the open market that has to be determined, the method of valuation or principles of valuation under both the Acts ought to be the same. We, therefore, reject the argument of the learned consul for the revenue that the goodwill value of the company ought to have been included in arriving at the break-up value of the shares.

23. The Assistant Controller made an addition of Rs. 10 a share on account of the expected dividend for the year 1967. No such addition was made by the Appellate Controller or the Tribunal. The department does not appear to have urged before the Tribunal that any such addition will have to be made. That apart, in our opinion, it is not open to the department to contend that an addition will have to be made on account of expected dividend for the year 1967. It is not clear from the order of the Assistant Controller, whether it is the dividend payable in 1967 for the year ended December 31, 1966, or the dividend payable in 1968 for the year ended December 31, 1967. It will be noticed that under Explanation II(ii)(b) of rule 1D of the Wealth-tax Rules, the amount set apart for payment of dividends on preference shares and equity shares where such

dividends have not been declared before the "valuation date" at a general body meeting of the company shall not be treated as liabilities. It was not shown before us that the net value of the assets of the company valued as Rs. 26,82,792 does not include the amount set apart for payment of dividend on the shares. If the amount set apart for dividends has already been included in the net value of assets of the company and has been taken into account while arriving at the "break-up value" of the shares, the department cannot contend that an addition will have to be made on account of expected dividend for the year 1967. If what the Assistant Controller intended was the anticipated dividends for 1968, No addition can be made on that account since the accounts up to December 31, 1967, were published long after the date of death. Dividend is not like interest which accrues from day-to day. The right to claim dividend arises only on declaration of dividends and not before.

24. There is another way of looking at the problem before us. The market value of the shares as on March 31, 1967, as disclosed by the wealth-tax assessment order of 1967-68, is an important piece of evidence. In the absence of any other material, the Tribunal was justified in relying on the said evidence for purpose of valuation of the market value of the shares as on September 11, 1967. There is no material to show that the value of the shares had gone up since March 31, 1967. The only published information concerning the company on March 31, 1967, as well as September 11, 1967, is its published balance-sheet as at December 31, 1966, which alone could be relied on for purposes of valuation whether on March 31, 1967, or September 11, 1967. If there any published information subsequent to March 31, 1967, indicating that the value off the net assets of the company had increased, that would have been a relevant ground for making an addition to the market value as on March 31, 1967. Sri S. R. Rajasekhara Murthy submitted that the 400 bonus shares issued by the company after March 31, 1967, and that is a circumstance to be taken into account. That fact, however, in the opinion of the Tribunal, has not enchanced the value of the shareholdings. That was also the opinion of the Assistant Controller and the Appellate Controller. Bonus shares were issued in the ratio of four for every ten equity shares. If the value of 1,000 share was Rs. 1,69,020, the value of 1,000 old shares plus 400 bonus shares would remain the same. Where bonus shares are issued in respect of ordinary shares held in a company by a shareholder, they have to be valued by spreading the cost of old shares over the old shares and new bonus shares taken together if they rank *pari passu*. Vide Commissioner of Income Tax v. Dalmia Investment Company Ltd.

25. For the reason stated above, the Tribunal, in our opinion, was right in determining the market value of the shares in question at Rs. 1,69,020. Accordingly, the question referred is answered in the affirmative and against the department. The department will pay the costs of the accountable person. Advocate" fee Rs. 250.

26. Question answered in the affiermative.