

(2004) 04 KL CK 0010
In the High Court Of Kerala
Case No : IT Ref. No. 282 of 1999

Dr. K.C. Mammen

APPELLANT

Vs

Commissioner of Gift Tax

RESPONDENT

Date of Decision : 05-04-2004

Acts Referred:

Gift Tax Act, 1958 — Section 4(1), 6
Wealth Tax Rules, 1957 — Rule 11, 1D

Citation : (2004) 190 CTR 153

Hon'ble Judges : J.M. James, J;G. Sivarajan, J

Bench : Division Bench

Advocate : M . Pathrose Mathai and John Ramesh K.I. John, for the Appellant;
P.K.R. Menon and R. Amirtharaj and George K. George, for the Respondent

Judgement

1. The Tribunal, Cochin Bench has referred the following question of law for decision by this Court u/s 26(1) of the Gift-tax Act (for short "the Act") at the instance of the assessee :

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the valuation of the gift of the shares for the asst. yr. 1991-92 was to be made u/s 6 of the GT Act in accordance with Schedule III of the WT Act?"

2. The brief facts are as follows : The assessee, an individual, held shares in Malayala Manorama Co. Ltd. During the previous year relevant to the asst. yr. 1991-92, the valuation date 31st March, 1991, the assessee sold 9,640 shares of the said company to his close relatives at a value of Rs. 37 per share. The AO noticed that during the previous year relevant to the asst. yr. 1991-92 the assessee had gifted away 280 shares in the same company to his minor daughter and for the purpose of gift tax he valued the shares at Rs. 77.85 per share. Since the assessee had sold the other shares in the same previous year, the AO took the fair market value of the shares at Rs. 77.85 per share and on that basis he came to the conclusion that there was a gift involved in the sale to the extent of

Rs. 3,93,794 and the same was assessed to tax under the Act as deemed gift. The CIT(A) confirmed the assessment holding that the market value of the shares was to be taken at 77.85 per share in accordance with Schedule III of the WT Act. This was confirmed by the Tribunal in further appeal by the assessee.

3. The assessee then filed a Miscellaneous Petition, MP No. 118/Coch/1998 stating that a particular ground, namely, the applicability of Section 4(1)(a) of the Act in respect of the transaction in view of the restrictions contained in the articles of association of the company which issued shares to the assessee. The Tribunal, after considering the matter, rejected the said petition stating that there is no mistake in the order. It is, thereafter, the petitioner has filed an application against the order in GTA No. 25/Coch/1994.

4. We have heard Shri M. Pathrose Mathai, learned counsel appearing for the assessee and Shri P.K.R. Menon, learned senior counsel appearing for the Revenue.

5. Counsel for the assessee contended that there was no gift involved in the sale of shares at Rs. 37 per share. Counsel contended that the shares transferred by the assessee were shares of a private limited company in which there were restrictions on the right of transfer of shares and that it was not open to the AO or to the CIT(A) to enquire into the correctness of the valuation of the shares. Counsel submits that the sale price of Rs. 37 per share realised by the assessee was the value fixed by the auditor on the basis of the yield method. He further submitted that the valuation of deemed gift in accordance with Schedule III of the WT Act was not in order. Counsel contended that as regards the deemed gift, Schedule II of the Act was incorporated for the purpose of Section 4(1)(a) only w.e.f. 1st April, 1992 and that for the asst. yr. 1991-92 Schedule II to the Act has no application. Counsel also submitted that application of Schedule III to the WT Act arises only by virtue of Schedule II to the Act. He further submitted that the CIT(A) was under the erroneous impression that Schedule III of the WT Act was procedural in nature and so the amended provisions could be applied in respect of the asst. yr. 1991-92 also. Counsel relied on the decision of this Court in P.J. George v. CIT to contend that Schedule III is not clarificatory in nature so as to give retrospective effect. Counsel also relied on the decision of this Court in Wg. Commander A.G, Mathews (Retd.) v. CGT on the merits.

6. Learned senior counsel for the Revenue submitted that the question is one of valuation of unquoted equity shares under the Act. Senior counsel referred to the provisions, of Section 6(1) of the Act as amended w.e.f. 1st April, 1989 and Schedule II of the Act as also Schedule III of the WT Act inserted by the Direct Tax Laws (Amendment) Act, 1989 w.e.f. 1st April, 1989, particularly Rule 11 thereof. Senior counsel took us to Schedule II of the Act introduced w.e.f. 1st April, 1993 and Rule 5 thereof. Senior counsel submitted that Rule 1D is similar to Rule 11 of Schedule III to the WT Act and Rule 5 of Schedule E to the Act. Senior counsel with reference to the observations of the Tribunal and the decision of the Supreme Court in Bharat Hari Singhania and others Vs. Commissioner of

Wealth Tax (Central) and others, submitted that the method of valuation of a particular asset is a matter of procedure and not a matter of substantive law and therefore such a rule is applicable to assessments pending on the day such rule comes into force even though the assessments relate to assessment years prior to the coming into force of that rule. Senior counsel has also relied on the decisions of the Supreme Court in Commissioner of Wealth-tax Vs. Laxmipat Singhanian, , Commissioner of Wealth-tax Vs. Smt. Pushpawati Devi Singhanian, , Commissioner of Wealth Tax Vs. O.P. Tandon and others, and Smt. Manjushree Biswas Vs. Commissioner of Wealth Tax, . Senior counsel summed up his submissions by stating that the valuation of gift under the Act w.e.f. 1st April, 1989, has to be under Schedule II of the Act which in turn refers to Schedule III of the WT Act. Senior counsel further submitted that Schedule II of the WT Act contains provisions (rules) for valuation and Rule 1D is similar to r, 11 and further submitted that w.e.f. 1st April, 1993, Schedule II of the Act contains rules for valuation under the Act and Rule 5 of Schedule II of the Act dealing with unquoted equity shares in companies other than investment companies is similar to Rule 1D of the WT Rules and Rule 11 Schedule III of the WT Act. Senior counsel accordingly submitted that though the assessment year concerned in this case is 1991-92 the same being pending at the time of the introduction of Rule 11 of Schedule III of the WT Act and Rule 5 to Schedule II of the Act, the same is applicable.

7. A Division Bench of this Court had occasion to consider the question of valuation of unquoted shares in the context of sale of shares of the very same company for the asst. yr. 1986-87 in Wg. Comdr. A.G. Mathews (Retd.) case (supra). This Court referred to various decisions of the Supreme Court including the one relied on by the Revenue in Bharat Hari Singhanian's case (supra) and held that the proper method to be adopted for valuation of unquoted shares is the yield method and not the break up value method.

8. The stand of the Revenue is that the aforesaid decision was rendered with reference to the deemed gift in relation to the asst. yr. 1986-87 and that the deemed gift in the instant case relates to the asst. yr. 1991-92. According to the Revenue, the amendment made to Section 6(1) of the Act w.e.f. 1st April, 1989, as per which the value of the gift as on the date on which the gift was made should be determined in the manner laid down in Schedule II to the Act which in turn provides that the value shall be determined in accordance with the provisions of Schedule III to the WT Act. Rule 11 was inserted in Schedule III to the WT Act by the Finance Act, 1993 w.e.f. 1st April, 1993, which provides that the value of unquoted equity shares in companies other than investment Companies shall be determined in the manner set out in Sub-rule (2). There was no provision in Schedule III to the WT Act for valuation of unquoted shares of a private company other than an investment company. Schedule II to the Act introduced w.e.f. 1st April, 1993, by the Finance Act, 1993, Rule 1 thereof provides that subject to the provisions of Rules 2 to 7 the value of any property other than cash transferred by way of gift shall, for the purposes of the Act, be

determined in accordance with the provisions of Schedule III to the WT Act, 1957 which shall apply subject to modifications contained in the rule. Rule 5 of Schedule II to the Act provides that the value of unquoted shares in companies other than investment companies shall be determined in the manner set out in Sub-rule (2). Rule 1D of the WT Rules is similar to Rule 11 of Schedule III to the WT Act and Rule 5 of Schedule II of the Act. Thus, according to the Revenue by virtue of the provisions of Schedule II to the Act read with the provisions of Schedule III to the WT Act as it obtained from 1st April, 1993, valuation of unquoted equity shares in companies other than investment companies shall be determined in the manner set out in Rule 11 of Schedule III to the WT Act which is same as in Rule 1D of the WT Rules. It is the further stand of the Revenue that since Rule 1D of the WT Rules was held to be mandatory by the Supreme Court in *Bharat Hari Singhania's case* (supra), the AO has no option but to value the gift as provided under Schedule III to the WT Act in view of the Schedule II to the Act. Here it must be noted that rules for determining the value of shares and debentures gifted were provided in Schedule II to the Act by way of amendment made by Finance Act, 1993. In the Departmental Circular No. 657 dt. 30th Aug., 1993, the scope and effect of the said amendment was explained, It is stated that Schedule II to the Act provides that the value of any property other than cash will be determined in accordance with the provisions of Schedule III to the WT Act; that under the scheme formulated by the Finance Act, 1992, shares and debentures in companies are not liable to levy of wealth-tax; that the Finance Act, 1992 by way of consequential amendment omitted Part C of Schedule III to the WT Act which specified the mode for valuation of these shares and debentures in companies; that the deletion of these rules has created difficulties under the Act as no mode has been specified for determining the value of these shares and debentures and that Finance Act, 1993 has revived Part C of Schedule III to the WT Act in Schedule II to the Act to overcome this difficulty. It is further stated that the amendment takes effect from 1st April, 1993 and will accordingly apply in relation to the asst. yr. 1993-94 and subsequent years.

9. The contention of the Revenue is that the rule regarding valuation of shares is procedural in nature and therefore it will apply to all pending assessments. In the instant case, assessment was completed after 1st April, 1993, i.e., on 21st Feb., 1994 and therefore the valuation of the shares has to be determined in accordance with the provisions of Schedule III to the Wealth Rules.

10. A Division Bench of this Court in *P.J. George v. CIT* (supra) has held that Schedule III to the WT Act inserted w.e.f. 1st April, 1989 has no retrospective operation, The question whether Schedule III to the Act is procedural in nature or not was not considered in the said decision. However, the question, whether, Rule 1BB of the WT Rules is a provision of substantive law, not expressly rendered applicable to valuation for the earlier years and therefore only prospective or whether it is merely procedural and attracted to a pending case was considered by the Supreme Court in *Commissioner of Wealth Tax, Meerut Vs. Sharvan Kumar Swarup and Sons*, wherein it was held that Rule 1BB is

essentially a rule of evidence as to the choice of one of the well accepted methods of valuation in respect of certain kinds of properties with a view to achieve uniformity in valuation and avoiding disparate valuation resulting from application of different methods of valuation respecting properties of a similar nature and character. Rule 1BB was thus held to be procedural in nature. The Supreme Court in *Gaj Singh v. Settlement Commission* : [2001]247ITR586(SC) considered the question "whether the immovable properties referred to in para 7 of the Settlement Commission's order should be valued under Rule 1BB even for the assessment year prior to 1979-80" and answered in the affirmative by holding that this question is covered by its earlier decision in *Sharvan Kumar Swamp's case* (supra).

11. In view of the authoritative pronouncement of the Supreme Court in the aforementioned decisions it is settled that the rules regarding valuation of shares are procedural in nature and will apply to all pending proceedings. In the circumstances it is not necessary to deal with the other decisions relied on by the counsel for the parties on this issue. The Supreme Court in *Bharat Hari Singhania's case* (supra) has also held that Rule 1D of the WT Rules is mandatory and the authorities have no option but to apply it.

12. Had it been a case of gift simpliciter the matter would have ended there. Admittedly, the case, on hand is a deemed gift attracting the provisions of Section 4(1)(a) of the Act. As per Section 4(1)(a) of the Act as it stood upto the asst. yr. 1992-93 for the purposes of the Act where a property is transferred otherwise than for adequate consideration, the amount by which the market value of the property as on the date of the transfer exceeds the value of the consideration shall be deemed to be a gift made by transferor. Section 3(2) of the Act which is the charging provision says that subject to the other provisions contained in the Act there shall be charged for every assessment year commencing from the 1st day of April, 1987 a gift-tax in respect of the gifts, if any, made by a person during the previous year at the rate of 30 per cent on the value of all taxable gifts. Section 2(xii) defines "gift" means the transfer by one person to another, of any existing movable or immovable property made voluntarily and without consideration in money or money's worth and includes the transfer or conversion of any property referred to in Section 4, deemed to be a gift under that section. By virtue of the definition of gift-tax transactions covered by Section 4, it would appear that the mode of determination of the market value can be made u/s 6 of the Act. Can it be done? It is doubtful. Section 4(1)(a) of the Act only says that the difference between the market value of the property at the date of transfer and the value of the consideration shall be deemed to be a gift made by the transferor. This would show that there is no question of valuation of the gift as such by the application of Section 6 of the Act in the case of a deemed gift. Thus even after the amendment made to Section 6 of the Act by the Direct Tax Laws (Amendment) Act, 1989 w.e.f. 1st April, 1989, prescribing the manner in which value of gifts has to be determined (Schedule II), for the purpose of determining the difference between the market value of

the property on the date of transfer and the value of the consideration, Schedule II has no application. It is by virtue of the amendment to Section 4(1)(a) of the Act made by Finance (No. 2) Act, 1991 w.e.f. 1st April, 1992, the value of the property as on the date of the transfer, for the purposes of Section 4(1)(a), can be determined in the manner laid down in Schedule II to the Act. The amendment in para 82 of the said Act says "in Section 4 of the Gift-tax Act, 1958 in Sub-section (1) in Clause (a) for the words "market value of the property at the date of the transfer" the words and figures "value of the property as on the date of the transfer and determined in the manner laid down in Schedule II", shall be substituted w.e.f. 1st day of April, 1992". Thus, from the asst. yr. 1992-93 onwards only, the value of the property as on the date of transfer u/s 4(1)(a) can be determined in the manner provided in Schedule II to the Act which in turn refers to Schedule III to the WT Act can be applied and not for the earlier years.

13. The scope and effect of the amendment made to Section 4(1)(a) of the Act by the Finance (No. 2) Act, 1991 have been elaborated in Departmental Circular No. 621 dt. 19th Dec., 1991 thus :

"Rationalisation of the provisions relating to deemed gifts.

74. Under the existing provisions of Section 4(1)(a) of the GT Act, where a property is transferred otherwise than for adequate consideration, the amount by which the market value of the property on the date of transfer exceeds the value of the consideration is deemed to be a gift made by the transferor.

74.1 Since, for the purposes of valuation of gifts, the concept of "market value" has now been replaced by rules contained in Schedule II to the GT Act for determining the value of each category of gifted assets, Section 4(1)(a) has been amended so that deemed gift shall now be an amount by which the value of the transferred property determined in the manner laid down in Schedule II exceeds the value of the consideration.

74.2 This amendment will take effect from 1st April, 1992, and will, accordingly, apply in relation to the asst. yr. 1992-93 and subsequent years."

14. From the amendment to Section 4(1)(a) of the Act, it is very clear that but for such amendment so far as the deemed gifts are concerned, the provisions of Section 6 of the Act regarding valuation of gifts does not have any application. Here it must be noted that Section 4(1)(a) of the Act which deals with deemed gift as it stood prior to 1st April, 1992, provided for determination of the value of consideration upto 31st March, 1992, based on the market value of the property at the date of transfer. In such a case, there is no question of determining the market value of the consideration for the transfer with reference to Schedule II to the Act as provided u/s 6 of the Act. This is made explicit by the amendment to Section 4(1)(a) of the Act w.e.f. 1st April, 1992 and the Departmental Circular explaining the scope and effect of the amendment made to Section 4(1)(a) of the Act.

15. In short, the position is that so far as the gift simpliciter is concerned, the value has to be ascertained as provided u/s 6 of the Act which states that the value as on the date on which the gift was made shall be determined in the manner laid down in Schedule II to the Act. Schedule II to the Act in turn says that the value has to be determined in the manner provided in Schedule III to the WT Act. So, in respect of the gifts simpliciter, the value of the gift has to be determined on the basis of the provision of Rule 1D of the WT Rules. However, this method of valuation of shares will not be available to valuation for the purposes of arriving at the deemed gift. In other words, notwithstanding the amendment to Section 6 of the Act made by the Direct Tax Law (Amendment) Act, 1989 w.e.f. 1st April, 1989, providing for valuation of the gift in the manner provided in Schedule II to the Act, the valuation for the purpose of arriving at the deemed gift continued to be determined on the basis of the market value of the property as on the date of the transfer. To put it differently, the amendment of Section 6 w.e.f. 1st April, 1992, had no impact on Section 4(1)(a) of the Act. In the absence of a specific provision regarding the value of the consideration, the principles laid down by the Supreme Court in Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc., , Commissioner of Gift Tax, Bombay Vs. Smt. Kusumben D. Mahadevia, and in CGT v. Executors and Trustees of the Estate of the Late Shri Ambalal Sarabhai, (1988) 170 ITR 144 (SC) as applied in the decision of this Court in Wg. Commander A. G. Mathews (Retd.) (supra) will apply. In view of the aforesaid decisions, the proper method of valuation of unquoted shares of a private company, for the purposes of the Act, is the yield method.

16. In respect of deemed gifts, it is only w.e.f. 1st April, 1992, i.e., by virtue of the amendment to Section 4(1)(a) of the Act made by the Finance (No. 2) Act, 1991, the value of the consideration for the purpose of deemed gift can be determined in the manner laid down in Schedule II to the Act and consequently by applying the provisions of Schedule III to the WT Act which is similar to the provisions of Rule 1D of the WT Rules as it stood then.

17. In this view of the matter, it is unnecessary to decide the question whether Schedule II to the Act which is inserted in the Act by the Direct Tax Laws (Amendment) Act, 1989 and Schedule III to the WT Act is substantive or procedural in character. That apart, the question is settled by the decision of the Supreme Court mentioned (supra).

18. The contention of the Revenue, as already noted, is that the provision regarding valuation of shares is only procedural in nature and therefore it will apply to pending proceedings. If the method of valuation of shares for the purpose of the Act is purely procedural in nature, certainly, the amendment will apply to pending proceedings. Here it must be noted that the provisions of Section 4(1)(a) of the Act cannot be said to be a procedural provision. It is a substantive provision, in that the said provision brings in a new category of gift, namely, deemed gift and that in this provision the value of the consideration for

the purpose of deemed gift as per the amendment from 1st April, 1992, has to be determined in the manner provided in Schedule II to the Act. Since the deemed gift and manner of determination of the deemed gift are integrally connected and are integrated in one section, it cannot be said that the former limb of Section 4(1)(a) of the Act is substantive and the latter limb regarding the determination of value of the deemed gift is a procedural provision. According to us, the manner of determination of the consideration for transfer for the purpose of deemed gift provided in Section 4(1)(a) of the Act in an integrated whole and which cannot be separated to say that it is procedural in character. Here it must be noted that this was specifically made applicable only w.e.f. 1st April, 1992, i.e., in relation to the asst. yr. 1991-92 (sic) and subsequent assessment years (see Department Circular No. 621 dt. 19th Dec., 1991). Thus looked at from any angle, the position is clear that the application of Schedule II to the Act inserted by the Direct Tax Laws (Amendment) Act and applied for valuation of gifts by amending Section 6 also so far as deemed gifts u/s 4(1)(a) of the Act is only from 1st April, 1992 in relation to the asst. yr. 1992-93 and subsequent years. This is because Schedule II application was provided only by the amended Section 4(1)(a) of the Act by Finance (No. 2) Act, 1991 w.e.f. 1st April, 1992.

19. Here it must be noted that the assessee's contention before the Tribunal was that even after 1st April, 1989, different methods of valuation are provided; one regarding gifts simpliciter and the other regarding deemed gifts and that it is only from the asst. yr. 1992-93 the amended provisions of Section 4(1)(a) of the Act enabling the determination of valuation of consideration for transfer can be determined in the manner provided in Schedule II to the Act. The Tribunal did not accept the said contention stating that in view of the provisions of Section 6 of the Act, valuation of deemed gift has also to be made in accordance with Schedule II to the Act even though the assessment year was 1991-92. The Tribunal has taken the view that in view of the expanded manner of gifts made in Section 4(1)(a) of the Act, the method of valuation for the purpose of assessment is not provided in Section 4 of the Act and the method is given in Section 6 of the Act only. It is also stated that the question whether the amendment to Section 4(1)(a) of the Act has retrospective operation or not is not relevant to decide the issue. The decision of this Court in *CGT v. Mammen Mathew* (1986) 158 ITR 466 the decisions of the other Courts holding that for valuation of deemed gifts, the provisions of Rule 1D of the WT Rules will apply, was also relied. The decision of the Supreme Court in *Bharat Hari Singhania's* case (supra) in regard to the valuation of unquoted shares of companies other than investment companies for the purpose of WT Act under Rule 1D of the Rules upheld by the Supreme Court was also relied.

20. In view of our finding regarding the applicability of Schedule II to the Act to deemed gifts u/s 4(1)(a) of the Act, the decision of the Tribunal to the contrary cannot be sustained.

21. We accordingly answer the question referred in the negative, i.e., in favour of

the assessee and against the Revenue.