

(1973) 04 MAD CK 0022

In the Madras High Court

Case No : Tax Case No. 282 of 1967 (Reference No. 101 of 1967)

G.V. Kasthuriswami Naidu and Others

APPELLANT

Vs

Controller of Estate Duty

RESPONDENT

Date of Decision : 19-04-1973

Acts Referred:

Estate Duty (Controlled Companies) Rules, 1953 — Rule 15
Estate Duty Act, 1953 — Section 36, 36(1)
Estate Duty Rules, 1953 — Rule 14

Citation : (1973) 92 ITR 145

Hon'ble Judges : V. Ramaswami, J;G. Ramanujam, J

Bench : Division Bench

Advocate : S. Padmanabhan and S.V. Subramaniam, for Subbaraya Aiyar, Sethuraman and Padmanaban, for the Appellant; V. Balasubrahmanyam and J. Jayaraman, for the Respondent

Judgement

Ramanujam, J.—One G. Venkataswami Naidu died on July 5, 1957. The accountable person had declared the principal value of the estate of the deceased at Rs. 2,03,446. The Assistant Controller of Estate Duty, however, determined the value of the estate at Rs. 7,22,994. While determining that value he valued the shares of Messrs. Janardana Mills Ltd. held by the deceased and the firm of Messrs. G. Venkataswami Naidu & Co. of which the deceased was a partner at Rs. 140 against the market quotation of Rs. 87 per share in the Madras Stock Exchange on the date of the death of the deceased. He also valued the managing agency rights of Messrs. G. Venkataswami Naidu and Co. at Rs. 10,00,000 and fixed the deceased's 1/4th share therein at Rs. 2,50,000. The additions in respect of these two items were questioned by the accountable persons by filing an appeal before the Central Board of Direct Taxes.

2. Before the Board, it was contended that the 500 shares which were owned by the deceased individually were lying pledged with the banks at the time of his death for obtaining overdraft facilities and that the said shares were sold in 1959 at the rates ranging from Rs. 67 to Rs. 70 per share, and that, therefore, these

shares should be valued at the price for which they were actually sold. As regards the shares held by the firm in which the deceased was a partner, it was contended that the shares should be valued only at Rs. 87 per share being the market quotation in the Madras Stock Exchange on the relevant date. The Board, however, reduced the value of the shares from Rs. 140 to Rs. 110 per share taking into account the fact that the shares had a special appeal for buyer who is engendered by the prospects of acquiring control over the mills and as such the stock exchange quotation may not reflect the true value of the shares.

3. As regards the deceased's share in the managing agency rights, it was contended by the accountable persons before the Board that it is not "property", that it had no market value, that it is only a contract of personal service and that, therefore, it cannot be taken into account in valuing the estate of the deceased. The Board, however, held that the deceased's share in the managing agency rights is a valuable property and it being one of the assets left by the deceased cannot be left out of account. It, however, reduced the value of the managing agency rights from Rs. 10 lakhs to Rs. 6 lakhs.

4. At the instance of the accountable persons the Board has referred the following questions to this court:

"(1) Whether, on the facts and in the circumstances of the case, the Central Board is correct in the principle of valuation applied by them with reference to the shares held by the firm, M/s. G. Venkataswami & Co., and by the deceased at Rs. 110 ?

(2) Whether, on the facts and in the circumstances of the case, the Central Board had any material for valuing the shares at Rs. 110 instead of at the market value ?

(3) Whether, on the facts and in the circumstances of the case, the valuation at Rs. 110 per share of 500 shares held by the deceased and which were pledged with the Bank of Baroda and which ultimately were sold for a price ranging between Rs. 67 and Rs. 70 is valid in law ?

(4) Whether, on the facts and in the circumstances of the case, the managing agency rights of Messrs. G. Venkataswami & Co. is property passing on the death of the deceased ?

(5) Whether, on the facts and in the circumstances of the case, the principles of valuation of managing agency rights of M/s. G. Venkataswami Naidu & Co. are justifiable ?

(6) Whether, on the facts and in the circumstances of the case, there were materials for valuing the managing agency rights of M/s. G. Venkataswami Naidu & Co. at about 19\$ times the annual income, namely, at Rs. 6 lakhs ?"

5. Question No. 4 relates to the issue as to whether the managing agency rights is property passing on the death of the deceased. This question has been

specifically considered by this court in *R. Ranganayaki Ammal and Others Vs. The Controller of Estate Duty, Madras*, *J.K. Trust, Bombay Vs. Commissioner of Income Tax, Excess Profits Tax, Bombay City*, that the managing agency being a business and not purely a contract of personal service would be "property" and that "property" is a term of widest import signifying every possible interest which a person can acquire, hold and enjoy. In view of that decision the contention that the managing agency is a contract of personal service and as such has no value cannot be accepted. The said question is, therefore, answered in the affirmative and against the accountable persons.

6. Questions Nos. 1 to 3 relate to the value of the shares held by the deceased as well as by the managing agency firm, and questions Nos. 5 and 6 relate to the valuation of the managing agency rights of Messrs. G. Venkataswami Naidu & Co., of which the deceased was a partner.

7. It is the contention of the accountable persons that the 500 shares belonging to the deceased should be valued at the price they were sold by the bank to whom they had been pledged, that the balance of the shares should be valued at Rs. 87 which is the actual quotation in the Madras Stock Exchange on the relevant date, and that the valuation of the share at Rs. 110 by the Board is quite arbitrary and contrary to the provisions in Section 36 of the Estate Duty Act.

8. We can straightaway reject the contention that the 500 shares held by the deceased should be valued at the price which they actually fetched in the market when they were sold by the bank. It is seen that the bank to whom the 500 shares were pledged sold the same in the year 1959. That price cannot be taken to be the value of the shares on the relevant date, that is, on July 5, 1957. Therefore, the actual value of the 500 shares in the year 1959 cannot be taken to be the value of the shares on July 5, 1957.

9. The only further question is whether the quotation in the Madras Stock Exchange is to be taken as the basis or whether the special value fixed by the Board for the shares taking into account the fact that the person holding the shares had a dominating voice and control over the affairs of the mills should be taken to be the basis. Both the Assistant Controller as well as the Board proceeded on the basis that the market quotation of Rs. 87 per share in the Madras Stock Exchange on the date of the death of the deceased cannot represent the true value of the shares for the reason that the bulk of shares held by the deceased and by the firm of managing agents generally fetches more than the normal price as the acquisition of such shares enables the purchaser to exercise control over the affairs of the mills. The Assistant Controller, for the purpose of valuation of the shares, considered the net profits earned by the mills for the years ending December 31, 1955, and December 31, 1956, and said that the tendency of profits has been to go up and that the normal expectation would be at least for a continuation of the rate of profits at the figure for 1956. He took the distributable profits for 1957 as the measure of the future profit expectancy of the company and worked out the yield to be about 39% and the stock

exchange quotation is based on the normal yield on investments in textile business at 10 to 12%. He, therefore, held that the shares held by the deceased and the firm were worth more than three times their face value of Rs. 50 per share and that Rs. 140 per share will be the fair value of the share. The Board, however, did not adopt any particular basis for fixing Rs. 110 as the value per share. It felt that the rate of Rs. 140 per share is somewhat excessive but that the stock exchange quotation cannot also represent the true worth of the share. It observed:

"The stock exchange rate is generally a fair indication of the market value of a share. But if there are any special circumstances, they have also to be taken into account in arriving at the real value. More so in cases where the transfer at the stock exchange are only of a few shares here and there as in this case. It may be pointed out that the principle of the "special" purchasers has been accepted in *Inland Revenue Commissioners v. Clay*; *Inland Revenue Commissioners v. Buchanan*, [1914] 3 K.B. 466 . . In the present case, the large holding of shares of the Janardhana Mills by the deceased and the firm, in which the deceased was a partner, was of special interest to certain purchasers who were eager to buy these shares with a view to acquire control over the mills. In the presence of these circumstances, stray instances of sales at a particular price cannot be taken as a safe guide for arriving at the proper value of the shares. There are cases, of which the case under consideration is one, where the property has a unique appeal for the buyer. This appeal is engendered by the prospect of acquiring control over the affairs of the company. In arriving at the true market value, due weight has to be given to those specifically interested parties to whom the property in question has more than a normal commercial appeal."

10. It is thus clear that the Board has valued the shares on the basis that the large holding of the shares by the deceased and the firm in which he was a partner had a special appeal for the buyers trying to get control over the affairs of the mills. According to the Board such special circumstances showing probable and higher potential value of the shares cannot be altogether left out of account in valuing the shares. The question is whether the special circumstances relied on by the Board are relevant factors to be taken into account in valuing the shares.

11. The provisions of the Estate Duty Act, 1953, dealing with the determination of the principal value of properties are contained in Part V. Section 36 is general in its nature and it states that the principal value of any property shall be estimated to be the price which in the opinion of the Controller it would fetch if sold in the open market at the time of the deceased's death. Sub-clause (2) directs that there shall not be any deduction in the estimate on account of necessity to place the whole property in the market at one and the same time. Section 37 deals with the valuation of shares in a private company where alienation is restricted. We are not concerned with the other provisions in Part V except Section 41 which says that the value of any property for the purpose of

estate duty shall be ascertained by the Controller in such manner and by such means as may be prescribed. Rule 14 of the Estate Duty Rules, 1953, deals with the principles of valuation. Rule 15 of the Estate Duty (Controlled Companies) Rules, 1953, deals with the valuation of shares and debentures of controlled companies within the meaning of Section 17 for the purpose of estate duty. That rule provides that the principal value of the shares or debentures of the controlled companies may be estimated by reference to net value of the assets of the company in lieu of being estimated in accordance with the provisions of Section 36(1).

12. According to the learned counsel for the accountable persons, the normal method of valuing the shares in a company is to proceed u/s 36(1) and only in special cases the legislature has contemplated a different mode of valuation of shares such as the one set out in Rule 15(2) of the Estate Duty (Controlled Companies) Rules, 1953, where the net value of the assets of the company could be taken into account. In this case the assessee is a public limited company and, therefore, the provisions of Section 36 alone will come into play. As per Section 36(1) the value of the property has to be estimated at the price it would fetch if sold in the open market at the time of the deceased's death. As already stated, the stock exchange quotation for the company's shares on the date of death of the deceased was Rs. 87 per share as against the face value of Rs. 50. The Board has proceeded on the basis that if the shares held by the deceased and by the firm of which he was a partner, if sold in bulk, would get a higher price in the market in view of the fact that the person who owns such a bulk of shares will be in a position to control the affairs of the company and that, therefore, such a higher potential value has to be taken into account. The Board has relied on the decision in *Inland Revenue Commissioners v. Clay*, in support of the the said view. In that case the property was valued for the purpose of increment value duty under Section 25 of the English Finance Act of 1910 which provided that the gross value of the property shall be the amount if sold at the time in the open market by a willing seller in its then condition it might be expected to realise. The property however, adjoined nurses' home, the trustees of which desired to purchase the same for expanding their premises. The question arose as to whether the possibility of the nurses' home paying a higher price for the property can be taken into account in finding out the open market price. The Court of Appeal expressed that on a sale in "open market" it must be assumed that intending purchasers were aware of the fact that the nurses' home was prepared to give a higher price for the property and that its value would thereby be increased. But the principle of that decision may not apply to the facts of this case, for there is absolutely no evidence as to whether there was a possibility of any higher offer being made for the share in question, if sold either in bulk or otherwise. The Board's view that if the shares are sold in bulk any purchaser of such bulk shares would pay a higher price as he is likely to gain control of the affairs of the company is purely a conjecture. As a matter of fact, if the entire bulk of shares had been sold in the open market, there would be a tendency to

quote a lesser price by the purchaser. There is no material to show that there was any person desirous of purchasing such a bulk of shares at a higher price with a view to gain control of the company's affairs. Therefore, it is not possible to ignore the actual market quotation on the relevant date and to proceed to value the shares on a conjectural basis. Normally a quotation in the stock exchange represents the true market trend in the value of shares, but if there are circumstances to show that the market quotation cannot represent the true value, it is possible to ignore the same and to adopt a different mode of valuation of the shares. Take for instance the case of a company in respect of which a false rumour has been spread that it is not solvent. As a result of such false rumour the price of shares in the stock exchange may go down. The value of the shares quoted at that time under such circumstances may not be taken to represent the true value of the shares. But in this case there is no material to show that there was any extraneous circumstance which resulted in a lesser price being quoted for the shares.

13. As a matter of fact, the following circular dated 28th September, 1957, issued by the Board in exercise of its rule-making power under the Wealth-tax Act, 1957, for the guidance of the departmental officers takes the stock exchange quotation as the basis for valuing the shares in joint stock companies and securities issued by the Government:

"Shares in joint stock companies and securities issued by Government or local authorities which are the subject of dealings in a recognised stock exchange may be valued on the basis of the closing price quoted on the stock exchange on the valuation date. For this purpose, if an assessee is assessed within a State in which there is a recognised stock exchange, the price quoted on that exchange may be taken into account. However, if there is no recognised stock exchange in the State in which the assessee is assessed, the price quoted on the recognised stock exchange located in a State nearest to the State in which the assessee is assessed may be adopted."

14. Though that circular has been issued under the Wealth-tax Act and has nothing to do with the valuation of the shares under the Estate Duty Act, still the fact remains that the revenue normally values the shares by finding out the market quotation in the stock exchange for the relevant shares.

15. We do not, however, say that in all cases the market quotation should form the only basis of valuation. As we have already stated, if the market quotation in the stock exchange is shown not to reflect the true value, because of certain factors, the same can be ignored and a different mode of valuation may be adopted. In this case the Board has assumed that the shares would have fetched a larger price as they were being held in bulk by the deceased. The fact that the shares are being held in bulk by the deceased cannot ipso facto lead to the conclusion that the shares are more valuable. Section 36(1) refers to a sale in the open market which means that there will be buyers both for bulk purchases as also for a single share. Otherwise it would lead to this that the shares held by

a person in bulk will have to be differently valued from the other shares of the company. This definitely will lead to anomalies. We, therefore, feel that the normal method of valuing the shares by adopting the market quotation from the stock exchange will constitute a proper basis. Therefore, we hold that the shares in question have to be valued at Rs. 87 per share being the market quotation on the relevant date.

16. Then the further question is as to how the managing agency rights have to be valued. According to the learned counsel for the accountable persons the valuation of the managing agency rights in, this case at Rs. 6 lakhs by the Board is not justified. It is stated that the managing agency rights have come to an end by August 15, 1960, by virtue of Section 324 of the Companies Act of 1956 and, therefore, it has to be valued OR the basis that at the duration of managing agency is only for about three years. It is said that at the most the managing agency agreement can be exploited only for a period of three years and its value cannot, in any event, be taken to be more than the total remuneration of the managing agents for the said period of three years. It is pointed out by the accountable persons that even according to the Assistant Controller the remuneration receivable by the managing agents under the Companies Act, 1956, per year was Rs. 31,470 and three years' remuneration on that basis will come to Rs. 94,410. We are of the view that valuing the managing agency rights without reference to the provisions of the Companies Act, which puts an end to such rights after a particular date will be shutting our eyes to the realities and that, therefore, in valuing the managing agency rights on the date of the death of the deceased the managing agency agreement should be taken to subsist only up to August 15/ 1960, as the purchaser will not be blind to the said provision which puts an end to the managing agency rights as on that date. The Board has taken the view that it is possible for the purchaser to expect that the Central Government would not summarily terminate the managing agency agreement on 15th August, 1960. But we cannot agree with that view. How can the purchaser expect that the Government will not give effect to the statutory provisions already enacted ? The contention of the accountable persons that the remuneration which the managing agents would have earned for the three years will be the maximum value for the managing agency rights has, therefore, to be accepted. We hold, therefore, that the deceased's 1/4th share in the managing agency rights has to be taken as the 1/4th share in the three years' remuneration payable to the managing agents. We, therefore, answer questions Nos. 1 to 3 and 5 and 6 in the negative and against the revenue. The accountable persons will be entitled to their costs from the revenue. Counsel's fee Rs. 250.