

**(1980) 02 GUJ CK 0008**

**In the Gujarat High Court**

**Case No : Special Civil Application No. 121 of 1980**

Rajan Ramkrishna

APPELLANT

Vs

Commissioner of Wealth-tax, Gujarat-I

RESPONDENT

**Date of Decision : 29-02-1980**

**Acts Referred:**

Wealth Tax Act, 1957 — Section 13(1)

**Citation :** (1980) 17 CTR 293 : (1981) 127 ITR 1

**Hon'ble Judges :** B.J. Diwan, C.J.; S.B. Majmudar, J

**Bench :** Division Bench

**Advocate :** J.P. Shah, for the Appellant; G.N. Desai, for the Respondent

## **Judgement**

Divan, C.J.—The petitioner herein challenges the notice issued by the Commissioner of Wealth-tax under s. 25(2) of the W.T. Act seeking to revise the orders passed by the WTO in the case of the petitioner for the assessment years 1974-75 to 1977-78.

2. The petitioner is an individual and is being assessed in the status of an individual under the W.T. Act. The petitioner had submitted his returns of wealth for the assessment years 1974-75 to 1977-78, in respect of his wealth as on the valuation dates, March 31, 1974, to March 31, 1977, respectively, treating March 31, of each year as the relevant valuation date. In each of these four years under consideration, one of the assets shown by the petitioner in his return was the holding of shares in Cloth Traders Pvt., Ltd., a joint stock company which is an investment company. For each of the four years under consideration, the petitioner had valued the shares at Rs. 143.39, Rs. 235.59, and Rs. 219.48 and Rs. 245.41, respectively, and the valuation was shown as so much per share. The proceedings for the assessment of wealth for each of these four years were going on simultaneously and at the time of hearing before the WTO the representative of the petitioner submitted that the value per share would be Rs. 143.39, Rs. 164.68, Rs. 169.75 and Rs. 176.70 on each of the above valuation dates, respectively, and for the purposes of this valuation which was submitted at the

time of hearing before the WTO, reliance was placed on the decision of the Supreme Court in Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc., . However, the WTO rejected the revised valuation and instead chose to follow the Board's Circular No. 2(WT) of 1967, being the circular dated October 31, 1967, and he arrived at the valuation of Rs. 210, Rs. 219.56, Rs. 222.83 and Rs. 240.38, respectively, for these valuation dates. Ultimately, on the footing of these valuations, assessment orders were passed under s. 16(3) of the W.T. Act. In making the wealth-tax assessments, as shown by the assessment orders for the respective years, the WTO made assessment in accordance with the circular of October 31, 1967. Thereafter, the assessments were completed on February 21, 1978, for all these years.

3. The CWT, the respondent herein, issued a notice, annex."C" to the petition, being dated January 5, 1980, stating that on examining the wealth-tax proceedings in the case of the petitioner for the assessment years 1974-75 to 1977-78, it was noticed by the respondent that while computing the net wealth the WTO had adopted the value of the shares of Cloth Traders Pvt. Ltd., and had estimated the value per share on the average of "break up" value taking the assets and liabilities as per the balance-sheet and the yield method. According to the respondent, the value adopted was far below the market value. In the notice, it is stated that Cloth Traders Pvt., Ltd., is an investment company which holds shares of several companies, shares of which are quoted on the market and if the market value of these shares held by Cloth Traders Pvt., Ltd., is adopted as against the book value to arrive at the break-up value, then there would be a rise in the value of shares of Cloth Traders Pvt., Ltd., Accordingly, as is shown in the notice, the market value of the shares of Cloth Traders Pvt. Ltd., comes to Rs. 1,002, Rs. 840, Rs. 929 and Rs. 1,042 for the assessment years 1974-75 to 1977-78, respectively, and hence, according to the Commissioner, the respondent herein, there was under-assessment of wealth on account of under-valuation of the shares of the company. The WTO's orders dated February 21, 1978, were, therefore, erroneous in so far as they were prejudicial to the interests of the revenue. The respondent, therefore, intended to pass an order under s. 25(2) of the W.T. Act directing the WTO to recompute the value of the shares of Cloth Traders Pvt., Ltd., and to re-do the assessments for the four years under consideration in accordance with law. The respondent informed the petitioner that if he had any objection he should appear before the respondent on a particular day and show cause as to why such an order should not be passed.

4. The main question in this case is whether the circular of the Board dated October 31, 1967, is superseded by the subsequent decision of the Supreme Court in Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc., . In order to understand the background to this question, it should be noted that under the W.T. Act, s. 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."

5. Under s. 13, sub-s. (1) :

"All Officers and other persons employed in the execution of this Act shall observe and follow the orders, instructions and directions of the Board", and the "Board" has been defined in s. 2(f) to mean the Central Board of Direct Taxes constituted under the Central Boards of Revenue Act, 1963. Under s. 25(2) of the Act :

"..... the Commissioner may call for and examine the record of any proceeding under this Act, and if he considers that any order passed therein by a wealth-tax Officer is erroneous, in so far as it is prejudicial to the interests of revenue, he may, after giving the assessee an opportunity of being heard, and after making or causing to be made such inquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including an order enhancing or modifying the assessment or cancelling it and directing a fresh assessment."

6. But under sub-s. (3) :

"No order shall be made under sub-section (2) after the expiry of two years from the date of the order sought to be revised."

7. The circular dated October 31, 1967, which is shown to be Circular No. 2 (W.T.), is reproduced at Ex. B to the petition. The circular provided for the method of valuation of unquoted equity shares of investment companies and holding companies and instructions regarding valuation of unquoted equity shares of investment companies and holding companies and managing agency companies have been set out in the circular in supersession of all earlier instructions for the guidance of the WTOs. The method of valuing unquoted equity shares of investment companies which are substantially holding companies was as follows :

"An investment company, whose assets to the extent of 50% or more consist of shares in companies controlled by it will be treated as a holding company."

8. But it has not been shown that Cloth Traders Pvt., Ltd., is a holding company in the sense indicated in clause 3 of this circular. Therefore, resort will have to be had to the circular, para. 2 of which will apply, if the circular is at all applicable. That clause deals with unquoted equity shares of investment companies other than those which are substantially holding companies and the paragraph provides :

"An "investment company" has been defined in rule 1A(g) of the Wealth-tax Rules, 1957, as a company whose total income consists mainly of income which, if it had been the income of an individual, would be regarded as unearned income. Unearned income means all income other than "earned income" as

defined in the Finance Act of the relevant year. Although the definition of investment company would not cover a banking/insurance company, but to avoid all doubts in the matter, it is clarified that banking and insurance companies will not be treated as investment companies. Their shares will be valued under rule 1D of the Wealth-tax Rules, 1957.

The average of (a) the break-up value of the shares based on the book value of assets and liabilities disclosed in the balance-sheet, and (b) the capitalised value arrived at by applying a rate yield of 9% of its maintainable profit, will be taken to represent the fair market value of the shares of an investment company."

9. The mode of calculating maintainable profits of a company has been set out in the circular under clause 2. The maintainable profit thus arrived at have to be capitalised by adopting 9% rate of capitalisation. It is thus clear that the circular prescribes in the case of companies which are investment companies other than those which are substantially holding companies, the average of the break-up value of the shares based on the book value of assets and liabilities disclosed in the balance-sheet capitalised at 9% and the maintainable profit would be taken to represent the fair market value of the shares of investment companies.

10. As to what is the effect of the circular issued by the Board of Direct Taxes under the provisions similar to s. 13(1) of the W.T. Act, we have a series of cases. The first of those cases was that of the Supreme Court in P.R. Chowdhary and S. Gangoli Vs. The State of U.P., . In that case, Hidayatullah J., as he then was, observed in the last paragraph of the judgment at page 205 of the report :

"I entertain, however, some doubt as to whether the instrument sought to be registered should be in existence in the accounting year, before registration can be claimed. There is nothing in the Act which says this specifically. My brother has reasoned from the contents of the Act and the Rules that such a condition is implied. While I entertain some doubts, I am not prepared to record a dissent, more so as the Board of Revenue has issued instructions that all firms should be registered, whether the documents under which they were constituted existed in the accounting year or not, provided the Income Tax Officer was satisfied about the genuineness of the firms."

11. Thus, though Hidayatullah J., doubted the correctness of the conclusions otherwise, in view of the circulars and instructions issued by the Board of Revenue, he was prepared to agree with the rest of the learned judges of the Supreme Court on the interpretation of the Act and the Rules, and thus the indication given by Hidayatullah J., was that the circular issued by the Board would prevail. In Navnitlal C. Javeri Vs. K.K. Sen, Appellate Assistant Commissioner of Income Tax, "D" Range, Bombay, , the Supreme Court considered the effect of the circular issued by the Board and the effect of that decision in Navnit Lal C. Zaveri's case was thus summed up in the subsequent decision in Ellerman Lines Ltd. Vs. Commissioner of Income Tax, West Bengal, Calcutta, by the Supreme Court observing as follows at page 921 of the report :

"Now, coming to the question as to the effect of instructions issued u/s 5(8) of the Act, this court observed in *Navnitlal C. Javeri Vs. K.K. Sen*, Appellate Assistant Commissioner of Income Tax, "D" Range, Bombay, :

"It is clear that a circular of the kind which was issued by the Board would be binding on all officers and persons employed in the execution of the Act u/s 5(8) of the Act. This circular pointed out to all the officers that it was likely that some of the companies might have advanced loans to their shareholders as a result of genuine transactions of loans, and the idea was not to affect such transactions and not to bring them within the mischief of the new provision."

The directions given in that circular clearly deviated from the provisions of the Act, yet this court held that the circular was binding on the Income Tax Officer."

12. These two decisions of the Supreme Court in *Navnitlal C. Javeri Vs. K.K. Sen*, Appellate Assistant Commissioner of Income Tax, "D" Range, Bombay, and in *Ellerman Lines Ltd. Vs. Commissioner of Income Tax, West Bengal, Calcutta*, were considered by this court in *Becharadas Spg. & Wvg. Mills Co., Ltd., v. CIT* (income tax Reference No. 153 of 1976, decided on March 11, 1977) by the Division Bench consisting of J. B. Mehta, Acting C.J. and D. A. Desai J. There it was observed :

"We need not reiterate that the position of such benevolent circulars issued u/s 119 of the Act for meeting such cases of extreme hardship stands well settled after the decision of their Lordships in *Navnitlal C. Javeri Vs. K.K. Sen*, Appellate Assistant Commissioner of Income Tax, "D" Range, Bombay, , and in *Ellerman Lines Ltd. Vs. Commissioner of Income Tax, West Bengal, Calcutta*, . There their Lordships pointed out that the directions in such benevolent circulars, even though they may be deviating from the provisions of the Act, would be binding on the Income Tax Officers."

13. This position is well accepted and there are several decisions of the different High Courts in India, namely, the decisions of the Bombay High Court in *TATA IRON and STEEL CO. LTD. Vs. N. C. UPADHYAYA AND ANOTHER.* *TATA IRON and STEEL CO. LTD. v. KUM. D. V. BAPAT and ANOTHER.*, and in *Navnitlal Ambalal and Others Vs. Commissioner of Income Tax, Bombay City II*, , the decision of a Full Bench of the Kerala High court in *Commissioner of Income Tax Vs. B.M. Edward*, *India Sea Foods*, and of the Karnataka High Court in *M.M. Annaiah Vs. Commissioner of Income Tax, Mysore*, , and in *T.P. Kapadia Vs. Commissioner of Income Tax, Mysore*, . Thus, the legal position is that benevolent circulars are binding on all ITOs and WTOs, as the case may be, and on all the persons employed in the execution of the W.T. Act.

14. In *Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc.*, , the Supreme Court considered the question of the principles of valuation of shares for the purpose of the W.T. Act in the case of companies and *Jaganmohan Reddy J.*, speaking for the Supreme Court, has set out the principles after examining the different decisions on the point at page 633. He has

observed :

"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 to 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 the 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 that would be realised by the 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 fluctuations 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."

15. Thus, it is clear from what the Supreme Court itself has stated in *Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc.*, , that the Supreme Court was not laying down any hard and fast rule regarding the valuation of shares of companies. The break-up method and the yield method are both recognised to be methods which can be resorted to for purpose of valuation in appropriate cases. In our opinion, in view of what has been observed at page 634 stating that the principles which have been called out by the Supreme Court are not hard and fast rules, it cannot be said that the methods of valuation laid down by the Central Board of Direct Taxes in its circular of October 31, 1967, being Circular No. 2(WT) have been abrogated or nullified by the judgment of the Supreme Court in *Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc.*, . As a matter of fact, the Board itself has treated this circular of October 31, 1967, as alive and as in operation because after the judgment of the Supreme Court in *Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc.*, was delivered on September 13, 1972, a circular, being circular No. 118 (F. No. 319/16-73 WT) dated September 15, 1973 was issued modifying some of the original instructions issued in Circular No. 2(WT) of 1967. Therefore, according to the Central Board of Direct Taxes, even after the Supreme Court decision in *Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc.*, , Circular No. 2(WT) dated October 31, 1967, was in force and operative and those instructions were to be followed by the WTO and the ITO employed in the execution of the W.T. Act, to use the language of s. 13(1) of the W.T. Act. The modification introduced by the circular of September 15, 1973, has no bearing so far as the facts of the present case are concerned, but the circular indicates that, according to the Central Board of Direct Taxes, Circular No. 2(WT) has to be applied and the instructions in that circular have to be followed and implemented in all matters by the WTO concerned in so far as the circular was applicable.

16. We have already indicated that, according to the Supreme Court decision in *Ellerman Lines Ltd. Vs. Commissioner of Income Tax, West Bengal, Calcutta*, , even if there was a deviation from the law in the circulars and the circulars deviated from the legal position, the circulars were required to be followed by the WTOs, particularly when they were benevolent circulars which would go to the assistance of the assessee.

17. In the instant case, the WTO concerned had relied upon this very circular of the Board and had valued the shares in accordance with the principles laid down in that circular. The circular is binding on the Commissioner because he is also

one of the persons employed in the execution of the W.T. Act. The notice dated January 5, 1980, clearly indicates that the Commissioner, the respondent herein, was valuing the shares of Cloth Traders Pvt. Ltd., on principles different from the principles laid down by the Circular of October 31, 1967. Whereas that circular required that the assets held by a private limited company to which that particular clause applies should be valued on the basis of the book value of the assets held by the company concerned, the respondent proposed to value the shares of Cloth Traders Pvt. Ltd., on the footing of the market value of the Shares held by Cloth Traders Pvt., Ltd. Thus the whole basis of the action which he proposed to take under s. 25(2) was based on a violation of the instructions issued by the Board of Direct Taxes on October 31, 1967. Thus, he wanted to do something which it was not open to him to do, namely, to depart from the instructions set out in the circular of October 31, 1967. Mr. G. N. Desai, learned counsel for the department, has drawn our attention to the decision of the Calcutta High Court in Commissioner of Wealth Tax Vs. Executors to the Estate of Sir E.C. Benthall (decd.), . There the Calcutta High Court has laid down that for the purpose of computing wealth-tax the shares of a company have to be valued under s. 7 in accordance with the principles laid down by the Supreme Court in Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc., . It must be pointed out that in that case as in the case of Mahadeo Jalan, where the Supreme Court was concerned with the pre-1967 situation, the Calcutta High Court was concerned with the situation of assessment years 1957-58 and 1958-59. There, really speaking, there was no question of invoking the circular of 1967 on the facts of the case before the Calcutta High Court. In that situation, that is in respect of a situation which prevailed prior to October 31, 1967, the principle laid down by the Supreme Court and followed by the Calcutta High Court in Commissioner of Wealth Tax Vs. Executors to the Estate of Sir E.C. Benthall (decd.), would have to be applied but when there is a deviation from the law laid down by the Supreme Court in Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc., , the Board's circular of October 31, 1967, confirmed by the Board in the circular of September 15, 1973, when it partially modified the Circular of 1967 must be followed by the Commissioner, the respondent herein. Hence, this decision of the Calcutta High Court to which our attention was drawn by Mr. Desai does not help the department in the instant case.

18. Under these circumstances, it is obvious that the decision of the WTO which was in accordance with the circular of the Board of October 31, 1967, was not erroneous in law and it was the conclusion of the respondent when he issued the notice of January 5, 1980, which was contrary to the circular of the Board and in direct conflict with that circular. Under these circumstances, it cannot be said that the condition precedent to the exercise of jurisdiction under s. 25(2) of the Act, namely, that the order passed by the WTO was erroneous in so far as it was prejudicial to the revenue is satisfied. While exercising jurisdiction under s. 25(2) it was not open to the respondent to disregard the binding nature of the circular

of October 31, 1967, and to proceed to exercise jurisdiction under s. 25(2) on the footing that the shares should be valued on a principle altogether different from and contrary to the principle set out in the circular of October 31, 1967.

19. Under these circumstances, the notice, Ex. "C" to the petition, being the notice dated January 5, 1980, must be quashed and set aside. We, therefore, allow this Special Civil Application and quash and set aside the notice dated January 5, 1980, and direct that a writ of mandamus should issue restraining the respondent from acting in pursuance of the notice dated January 5, 1980. Rule is made absolute accordingly. The respondent will pay the costs of this Special Civil Application to the petitioner.