

PETITIONER:
COMMISSIONER OF GIFT TAX, GUJARAT

Vs.

RESPONDENT:
EXECUTORS & TRUSTEES OF THE ESTATE OF LATE SH. AMBALAL SARABH

DATE OF JUDGMENT 11/12/1987

BENCH:
VENKATACHALLIAH, M.N. (J)
BENCH:
VENKATACHALLIAH, M.N. (J)
NATRAJAN, S. (J)

CITATION:
1988 AIR 522 1988 SCR (2) 341
1988 SCC Supl. 115

ACT:

Gift Tax Act, 1958: Section 15(3)-Gift of shares-Correct-Principles of valuation-Whether a question of law-Shares not quoted on stock exchange-What is the method of valuation applicable to.

HEADNOTE:

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The assessee contended in the gift tax assessment proceedings that the 480 shares in the English Company acquired as gift were not quoted in the stock exchange, that their value be determined on the average break-up value indicated by the balance sheets of the Company as on 31.3.1964 and 31.3.1965, and that in view of the decision of the General Body of the Company dated 4.10.1961 to increase its share capital by issue of additional shares the value of the shares constituting the subject matter of the gifts which were transferred "ex-right" would stand depreciated.

The Gift Tax officer valued the shares on the basis of the breakup value yielded by and deductible from the balance sheet as on 31.3.1964. The Appellate Assistant Commissioner dismissed the assessee's appeal.

In the further appeal before the Income-tax Appellate Tribunal, the Tribunal, relying on the ratio laid down in the English Case, *Lynall and another, v. Inland Revenue Commissioner*, 83 I.T.R. 563 valued the shares at Rs.450 each, said to represent the break-up value on the basis of the balance sheet of 31.3.1963, holding that it could not take into consideration any other document except the published information, which was the aforesaid balance sheet.

The Tribunal stated a case and referred the matter to the High Court, for its opinion. The High Court held that since the only information which was available on the date of the gifts was in the form of the balance sheet as of March 31, 1963, the Tribunal was right in taking the same into consideration, for the purpose of arriving at the value of the shares by the 'break-up' method.

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In the appeal to this Court it was contended on behalf of the Revenue that the principle of valuation relied upon by the High Court was erroneous, and that the case was

covered by the decisions of this Court in Commissioner of Wealth Tax, Assam v. Mahadeo Jalan & Ors., 86 ITR 621 and Commissioner of Gift-Tax, Bombay v. Smt. Kusumben Mahadevia, 122 ITR 38.

On behalf of the assessee it was urged that in view of the consensus between the parties as to the basis of valuation, it was not now open to the Revenue to urge the application of an altogether different principle.

Disposing of the appeal,

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HELD:1. The correct principle of valuation applicable to a given case is a question of law. The parties can agree upon a principle permissible and recognised by law. If two or more alternative principles are equally valid and available it might be permissible for the parties to agree upon one of the alternative modes of valuation in preference to another. [346G-H]

In the instant case, the Revenue cannot be precluded from urging the correct legal position. [347A]

2. When the shares in a public limited company are not quoted on the stock exchange. Or are in a private limited company the proper method of valuation to be adopted would be the profit earning method.[346B-C]

Commissioner of Gift- Tax, Bombay v. Smt. Kusumben D. Mahadevia, 122 ITR 38, relied upon.

Commissioner of Wealth Tax, Assam v. Mahadeo Jalan & Ors., 86, ITR 621 and, Williams J in Mc. Cathie v. Federal Commissioner of Taxation, 69 C.L.R. 1, referred to.

In the instant case, the view of the High Court as to the principle of valuation in determining the value of the kinds of shares concerned cannot be held to be correct. As a logical consequence, the Tribunal would have to go through, over again, the exercise of determination of the value of the shares adopting the correct principle. But, having regard to the fact that the matter is already two and a half decades old, and that the magnitude of the mechanism for the re-fixation of the value of the gifts by adopting the somewhat intricate process inherent in the

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"profit method" of valuation, and the difference in the quantum of tax that might result in, do not bear a reasonable or sensible proportion, the valuation is left undisturbed.[347A-D]

JUDGMENT:

CIVIL. APPELLATE JURISDICTION: Civil Appeal No. 982 (NT) of 1975.

From the Judgment and order dated 10.10.1974 of the Gujarat High Court in Gift Tax Reference No. 1 of 1973.

Dr. V. Gauri Shanker, K.C. Dua, C.V. Subha Rao and Miss A. Subhashini for the Appellant.

T.A. Ramachandran, Sonet P. Mehta. D.N. Misra and Ms. Sunita Narhari for the Respondent.

The Judgment of the Court was delivered by

VENKATACHALIAH, J. This appeal, by certificate, by the Commissioner of Income-Tax, Gujarat, directed against the order dated, 10.10.1974 of the Gujarat High Court in Gift Tax Ref. No. 1 of 1973 raises a question touching the correct principles of valuation of certain shares constituting the subject-matter of a gift, held in a company incorporated in the United Kingdom analogous to a private limited company in India.

2. Shri Ambalal Sarabhai, since deceased, held 480

shares in an English Company M/s. Bakubhai & Ambalal Ltd., London, the share-capital of which consisted of 2000 shares of 10 each. On 17.10.1964, under eight deeds of gift, the said Ambalal Sarabhai made gifts of the said 480 shares to certain members of his family. In the proceedings of the assessment to gift-tax respecting said gifts the question of the proper basis for determination of the value of the gifts having arisen, the assessee contended that, as the shares were not quoted in the stock-exchange, their value be determined on the average of break-up value indicated by the balance-sheets of the Company as on 31.3.1964 and 31.3.1965. The former figure was Rs.507 and the latter Rs.333 per share; the average of the two being Rs.420 per share.

The assessee also contended that in view of the decision of the General Body of the company, dated, 4.10.1961 to increase its share-capital by issue of additional 2000 shares at 10 each, the value of the shares constituting the subject-matter of the gifts which were transferred "ex-right" would stand depreciated.

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The Gift Tax Officer did not accept the contentions of the assessee. He proceeded to value the shares at Rs.507 per share on the basis of the break-up value yielded by and deducible from the balance-sheet as on 31.3.1964. The Appellate Assistant Commissioner dismissed the assessee's appeal. In the further appeal before the Income Tax Appellate Tribunal, the Tribunal, placing reliance on what it considered to be the principles of valuation appropriate to such cases said to be contained in *Lynal & Anr. v. I.R. C.* (H.L.), (83 ITR 563), valued the shares at Rs.450 each said to represent the break-up value on the basis of the balance-sheet of 31.3.1963. The Tribunal held that it could not take into consideration any other document except the published information which, in this case, was the balance-sheet as on 31.3.1963.

3. The Tribunal, at the instance of both the revenue and the assessee stated a case and referred three questions of law for the opinion of the High Court-the first two at the instance of the revenue and the third at the instance of the assessee. The assessee, it must be observed did not press the question referred at his instance and the High Court, accordingly, did not express any opinion on it. The two questions referred for the opinion of the High Court at the instance of the Revenue were:

- "(1) Whether on the facts and in circumstances of the case. the finding of the Tribunal based on the ratio of the case decided by the House of Lords in *Lynall and Another v. Inland Revenue Commissioner*, (83 I.T.R. 563) and basing the valuation of the shares of Bakubhai and Ambalal Ltd., London, on its balance sheet as at 31.3.63 instead of 31.3.64 is bad in law?
- (2) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in accepting the valuation of the shares as returned by the assessee and deleting Rs.27,360 added by the Gift-Tax officer under Section 15(3) of the Act?"

The High Court by its order, now under appeal, answered the questions against the revenue. It held:

"The only information which was available as on October, 17, 1964 was in the form of the balance-sheet as of March 31, 1963 and hence the Tribunal was right when it took into consideration for the

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shares by the break-up method, the balance sheet as at March 31, 1963 and not as the revenue was contending for the balance sheet as of March 31, 1964."

4. Dr. Gauri Shanker, Learned Senior Counsel urged in support of the appeal, that the entire exercise of valuation before the High Court rested on a case which had no application to the matter; that the case was governed squarely by the pronouncements of this Court in Commissioner of Wealth Tax, Assam v. Mahadeo Jalan & Ors., (86 ITR 621) and, more particularly, in Commissioner of Gift-tax, Bombay v. Smt. Kusumben D. Mahadevia, (122 ITR 38) and that the erroneous view of the High Court as to the principles of valuation should, therefore, not remain uncorrected.

5. Shri Ramchandran, learned senior counsel for the assessee, in the light of the aforesaid pronouncements to this court, found it difficult to support the principles on which the determination of the value of the shares proceeded before the authorities as well as before the Tribunal and the High Court. He, however, invited our attention to the following observations of the High Court:

" .. As a matter of fact it may be pointed out that before the Tribunal it was common ground that the value of the shares should be ascertained by following the break-up value method and the only difference was as to with reference to balance sheet of what date the total value of the assets has to be ascertained

and urged that in view of the consensus between the parties as to the basis of valuation it was not now open to the Revenue to turn around and urge the application of an altogether different principle.

6. We are afraid, the basis adopted by the High Court is clearly unsustainable in the light of the pronouncements of this court referred to earlier. The reference to and reliance upon the Lynall principle was somewhat in-apposite and misplaced. That case principally dealt with the impermissibility of reliance on classified information considered confidential and privileged from disclosure. Pointing out the inadequacy of the "break-up-value" method this court in Mahadeo Jalan's case referred with approval to the following observations of Williams J in Mc. Cathie v. Federal Commissioner's of Taxation (69 C.L.R. 1):

" .. the real value of the shares .. will depend

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more on the profits which the company has been making and should be capable of making, having regard to the nature of its business than upon the amounts which the shares would be likely to realise upon liquidation

In Kusumben's case referring to the principles of valuation relevant to the matter, this court said:

"..... But where the shares in a public limited company are not quoted on the stock exchange or the shares are in a private-limited company the proper method of valuation to be adopted would be the profit earning method. This method may be applied by taking the dividends as reflecting the profit earning capacity of the company on a reasonable commercial basis but if it is found that the dividends do not correctly reflect the profit earning capacity because only a small proportion of the profits is distributed by way of dividends

and a large amount of profits is systematically accumulated in the form of reserves, the dividend method of valuation may be rejected and the valuation may be made by reference to the profits. The profit-earning method takes into account the profits which the company has been making and should be capable of making and the valuation, according to this method is based on the average maintainable profits. Of course, for the purpose of such valuation, the taxing authority is not bound by the figure of profits shown in the profit and loss account because it is possible that the amount of profits may have suffered diminution on account of unreasonable expenditure or the directors having chosen to take away a part of the profits in the form of remuneration rather than dividends. The figure of profits in such a case would have to be adjusted in order to arrive at the real profit earning capacity of the company

....."

The view of the High Court cannot, therefore, be said to reflect the position in law correctly.

7. The correct principle of valuation applicable to a given case is a question of law. The parties can agree upon a principle permissible under and recognised by law. If two or more alternative principles are equally valid and available, it might be permissible for the parties to agree upon one of the alternative modes of valuation in preference to

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another. In this case, the revenue cannot be said to be precluded from urging the correct legal position. In the ultimate analysis, it requires to be held that the view of the High Court as to the principle of valuation in determining the value of the kind of shares concerned in this case cannot be held to be correct. The first question of law referred for its opinion would otherwise, require to be answered in the affirmative and the second in the negative; both against the assessee. As a logical consequence, the Tribunal would have to go through, over again, the exercise of determination of the value of the shares adopting the correct principle.

8. But the matter is already two and a half decades old. The gift was in the year 1964. The total Gift-Tax as now assessed is Rs.5661. Upon a fresh determination of the value of the shares adopting the somewhat intricate processes inherent in the 'profit-method' of valuation the difference in the quantum of the tax might, perhaps, not be substantial. The magnitude of the mechanism for refixation of the value of the gifts and the difference in the quantum of the tax it might result-in, do not bear a reasonable or sensible proportion. Having regard to the pecuniary involvement in the case which is obviously small we think we should not expose the parties to a fresh round of litigation.

In this view of the matter, we think appellant should be content with the declaration of the law on the matter, without disturbing the valuation made by the Tribunal and approved by the High Court. though the principle adopted is not supportable in law. We therefore decline to interfere in the matter. The valuation is therefore left undisturbed .

9. The appeal is disposed of accordingly. In the circumstances of the case, there will be no order as to costs.

N.P.V.

Appeal disposed of.

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JUDIS