SUPREME COURT OF INDIA

Gift-tax Commr., Gujarat

Vs.

Executors and Trustees

C.A.No.982 (NT) of 1975

(S. Natarajan and M. N. Venkatachaliah, JJ.)

11.12.1987

JUDGEMENT

VENKATACHALIAH, J.:-

1. 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. 1of 1973 : (reported in (1975) 39 Taxation 7) 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 and 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 gift 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.

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 Lynall v. I.R.C., (1972) 83 ITR 563 (H.L.) 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 v. Inland Revenue Commissioner, (1972) 83 ITR 563 and basing the valuation of the shares of Bakubhai and Ambalal Ltd., London, on its balance-sheet as at 31-3-1963 instead of 31-3-1964 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 purpose of arriving at the value of the shares by the break-up method, the balance-sheet as of March 31, 1963 and not as the revenue was contending for the balance-sheet as of March 31, 1964."

4. Dr. Gauri Shankar, 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 pronoucements of this court in Commr. of Wealth-tax, Assam v. Mahadeo Jalan, 86 ITR 621 : (AIR 1973 SC 1023) and, more particularly, in Commr. of Gift-Tax, Bombay v. Smt. Kusumben D. Mahadevia, 122 ITR 38 : (AIR 1980 SC 769 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 of 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 unsutainable 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 "breakup-value" method this court in Mahadeo Jalan's case referred with approval to the following observations of Williams J. in Mc. Cathic v. Federal Commissioner's of Taxation, (1944) 69 CLR 1 :

" ......the real value of the shares ....will depend 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 (AIR 1980 SC 769) referring to the principles of valuation relevant to the matter, this court said (at p. 772) :

"..........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 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 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.

Order accordingly.

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