ANDHRA PRADESH HIGH COURT

Commissioner of Income-Tax

Vs

M. Lakshmaiah

(G.R Naidu,CJ. Y Anjaneyulu, J.)

10.03.1988

JUDGMENT

Anjaneyulu, J.

1. This reference arises under the Wealth-tax Act, 1957. At the instance of the Commissioner of Wealth-tax, the following question is referred for the consideration of this court under section 27(1) :

> "Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in holding that either the provision for advance tax or even advance tax paid should not be deducted from the provision for taxation exhibited as a liability, while working out the market value of unquoted equity shares in accordance with rule 1D of the Wealth-tax Rules, 1957 ?"

2. The reference relates to two separate assessees. Maddi Lakshmaiah is the assessee in connection with the assessment year 1976-77 and the corresponding valuation date in his case was December 31, 1975. Maddi Seetha Devi is the assessee for the assessment year 1980-81 and the corresponding valuation date in her case was March 31, 1980. In both these cases, a question arose in connection with the valuation of shares held by the two assessees in a company known as "Maddi Lakshmaiah Private Limited." It is common ground that the company being a private limited company, its shares are not quoted on the stock exchange, and, therefore, their value has to be determined in accordance with rule 1D of the Wealth-tax Rules, 1957. In connection with the assessment year 1976-77, the Wealth-tax Officer found that the assessee was holding 4,000 shares in the company. The market value of each share was reckoned at Rs. 383.08 and applying the provisions of rule 1D, the value was determined at Rs. 274.36 per share. For the assessment year 1980-81, the assessee was likewise holding 2,500 shares in the company; the value in accordance with rule 1D was worked out by the Wealth-tax Officer at Rs. 483.31 per share. The assessees objected to the value of the shares computed by applying the provisions contained in

rule 1D. The contention urged in particular was that the Wealth tax Officer committed an error in disallowing the provision for taxation made by the company. The assessees' claim was that the entire provision should be regarded as a liability and deducted in ascertaining the net value of the assets of the company for the purpose of determining the break-up value of the shares.

3. The Commissioner of Wealth-tax (Appeals) indicated in his order what, according to him, should be the correct method of working out the excess provision for the purpose of disallowance under rule 1D on the liabilities side and directed the Wealth-tax Officer to adjust the assessments accordingly. For the purpose of giving these deductions, the Commissioner had taken certain assumed figures. He would have done well in taking the actual figures according to the balance-sheets and working out the value of each share according to rule 1D instead of entering into a hypothetical exercise and indicating how the value should be reckoned for the purpose of rule 1D. The assessees were obviously not satisfied with the formula indicated by the Commissioner of Wealth-tax (Appeals). Accordingly, appeals were filed before the Tribunal questioning the method indicated by the Commissioner of Wealth-tax (Appeals) in his order. Before the Tribunal, the plea was reiterated by the assessees that for the purpose of working out the share value under rule 1D, the entire provision made by the company in the balance-sheets for the two assessment years under consideration should have been excluded. The Tribunal also, unfortunately, did not go into the relevant particulars. There is no indication that the Tribunal called for the balance-sheets of the company and verified the manner in which the Wealth-tax Officer had worked out the break-up value for the assessment years under consideration. On the contrary, the Tribunal dealt with the law at considerable length and upheld the formula indicated by the Commissioner of Wealth-tax (Appeals). Apparently, the assessees did not consider it expedient to question the order of the Tribunal, but then the Revenue was aggrieved by the order of the Tribunal and filed applications under section 27(1) and secured the present reference. We have already indicated the question referred for the consideration of this court in paragraph (1) (see p. 6 supra).

4. We have heard Sri M. Suryanarayana Murthy, learned counsel for the Revenue and Sri M. J. Swamy, for the assessees. At the time of hearing of the reference, we were considerably handicapped as the relevant particulars relating to the computation of the value of each share as held by the Wealth-tax Officer were not available. We called upon learned standing counsel to secure the records from the Wealth-tax Officer so that we can find out the manner in which the share value was computed and whether, in computing the value, the Wealth-tax Officer committed any error. The records have since been placed before us. We find the records equally unhelpful as we will presently indicate.

5. The manner in which the market value of unquoted equity shares of companies should be computed is indicated in rule 1D. Omitting the particulars not necessary for our present purpose,

we may refer to Explanation 11 of the rule which provides, inter alia that any amount paid as advance tax under section 18A/210 shall not be treated as an asset. The Explanation also refers to the amounts shown as liabilities in the balance-sheet which should not be treated as liabilities for the purpose of the rule. The items of liabilities which should be disregarded are specified in clause (ii) of Explanation II. We are concerned with sub-clause (e) which specifies that any amount representing provision for taxation (other than the amount referred to in clause (i)(a)) to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto shall not be treated as a liability. We must at once point out that the language employed is cumbersome and, unfortunately, this led to different views in interpretation. Explained in simple language, the position turns out as under : Whatever amount of advance tax paid by an assessee appearing as an asset in the balance-sheet shall be excluded and only the balance of the assets shall be taken into consideration for the purpose of rule 1D. To this extent, there is no difficulty. Now, coming to the liabilities side, there are items of liabilities which are required to be disregarded and no controversy centres round them. But the controversy is now with regard to the provision for taxation. Sub-clause (e) of clause (ii) of Explanation II, in terms, provides that an adjustment must be made, if called for, to the amount appearing as "provision for taxation" in the balance-sheet. Take, for instance, a case where the tax payable on the income, profits and gains for the relevant year is Rs. 100. Against the tax payable for that year, assume that Rs. 80 had been paid by way of advance tax and shown as an asset in the balance-sheet. The balance of the tax payable will then be Rs. 20 for which a provision could be made in the books of account and a provision, to that extent, will appear in the balance-sheet on the liabilities side. Let us also assume that in the books, the company made a provision for Rs. 100 for the purpose of taxation and appearing as a liability in the balance-sheet. The question now for consideration is how the two amounts shall be adjusted. The amount of Rs. 80 already paid as advance tax and appearing on the assets side of the balance-sheet has to be disregarded and excluded from the assets side so that tax to the extent actually paid gets allowed in working out the net value of the assets. Now, if the actual tax on the book profits is Rs. 100, the provision for taxation that ought to be made by an assessee is only Rs. 20, because advance tax of Rs. 80 had already been paid. Therefore, the sum to be treated as a provision for taxation for the relevant assessment year is Rs. 100 minus Rs. 80, and only the resultant Rs. 20 should be deducted by way of liability for the purpose of rule 1D. If the assessee's balance-sheet shows any sum in excess of Rs. 20 by way of provision for taxation, then sub-clause (e) of clause (ii) of Explanation II provides that the excess shall be disregarded. In the given illustration, the provision made is Rs. 100. The excess over Rs. 20 has to be excluded from the liabilities side. Now, the entire exercise, as we see, is to ensure that the total amount of tax payable by an assessee on the income, profits and gains for the relevant assessment year is allowed as a deduction. The deduction is allowed partly by excluding the advance tax already paid from the

assets side and partly by allowing the balance by way of provision for taxation on the liabilities side. If the provision for taxation made is in excess of what is really required for the purpose of paying tax on the book profits for the relevant assessment year, then, obviously, the excess does not represent a proper liability and, therefore, the rule requires that that liability should be disregarded. This, according to us, is the real and simple effect of the adjustments directed to be made by sub-clause (e), but then the assessees' case is that while excluding advance tax from the assets side, the entire provision made by the company in the balance-sheet should be allowed as a deduction and no part of it should be disallowed. This argument has the consequential effect of (a) allowing Rs. 80 which was already advance tax paid and (b) once again allowing the entire amount of tax of Rs. 100 for which provision has been made. We do not think that this is the legislative intention. All that the assessee can bargain for is that in working out the net assets of the company, the tax payable for the relevant assessment year should be deducted, and that tax might conceivably represent partly the advance tax already paid and the other part being the provision made at the end of the year. Surely, an assessee cannot ask for deducting, by way of liability, more tax than what is pay able on the income, profits and gains of the relevant assessment year.

6. Learned counsel for the assessee relied on the decision of the Gujarat High Court in CWT v. Ashok K. Parikh and also a subsequent decision of the same High Court in CWT v. Arvindbhai Chinubhai and a later judgment of the Bombay High Court in CWT v. Pratap Bhogilal . According to learned counsel, the decisions of the Gujarat High Court as well as that of the Bombay High Court lend support to his plea that while excluding the advance tax paid on the assets side, the entire amount of tax payable on the income, according to the books, appearing on the liabilities side in the balance-sheet as provision for taxation should be allowed without exclusion. With great respect, we are unable to agree with the aforesaid view of the Gujarat and Bombay High Courts. We have already explained that we cannot attribute to the Legislature the intention of allowing a liability greater than what is really necessary for the purpose of paving taxes for the relevant assessment year on the book profits. Indeed, the decisions of the Gujarat High-Court and the Bombay High Court are to that effect. Our attention has been invited to the contrary view taken by the Karnataka and Punjab and Haryana High Courts. The Karnataka decision is reported in N. Krishnan and the Punjab and Haryana decision in Ashok Kumar Oswal (Minor) v. CWT . The Karnataka and Punjab and Haryana High Courts have interpreted rule 1D of the Wealth-tax Rules in the same manner as it appeals to us. We would, in the circumstances, hold that the real effect of sub-clause (e) of clause (ii) of Explanation II to rule 1D is to permit the deduction of provision for taxation only to the extent that is necessary for ensuring the deduction of the total liability relating to the assessment in respect of the income, profits and gains for that year and it does not have the effect of allowing provision for taxation in excess of

what is required to be allowed.

7. Now, in the present case, we do not know how the Wealth-tax Officer had worked out the valuations. We have reasons to think that the Wealth-tax Officer had not worked out the valuations correctly. For instance, we have perused the record for the assessment year 1976-77. According to the record, the total assets were taken at Rs. 3,73,60,162 whereas we find that the correct figure is Rs. 3,73,63,162. There is an identical difference in the total extent of liabilities also. And then, the Wealth-tax Officer excluded advance tax of Rs. 12,99,000 from the gross assets. We do not find any advance tax payment on the assets side of the balance-sheet and we do not know how he arrived at this figure. It is possible that this is included in some other item, but there is no means of verification. Similarly, we find that the Wealth-tax Officer excluded the entire provision for taxation at Rs. 16,61,000 as if it represented the excess in terms of sub-clause (e). He did not make any endeavour to find out the tax payable on the income, profits and gains according to the books for the assessment year 1976-77, deduct therefrom the advance tax paid and ascertain the balance to be taken as provision for taxation. He failed to note that it is only the excess that can be disregarded. The Wealth-tax Officer felt into the error of thinking that any amount provided by way of provision for taxation should be excluded. This is patently wrong. Then, there is a sum of Rs. 2,64,082 added to the resultant figure. We do not know how this was arrived at and what it meant. We have indicated these discrepancies to highlight that at no stage did any of the appellate authorities check up the accuracy of the working of the Wealth-tax Officer and directions were given on the basis of assumed figures. This, in our opinion, is wrong. As a final fact-finding authority, the Tribunal should have gone into the question of determination without leaving the matter to be sorted out at the High Court stage. We would now direct the Tribunal to check up the correctness or otherwise of the working of the Wealth-tax Officer for both the assessment years under consideration, based on the balance-sheet figures of the company for the relevant years. This may be done while passing an order in conformity with the directions of this court. The assessees as well as the Department will be given an opportunity to place correct workings. The Tribunal, after working out the correct figures, may grant appropriate relief to the assessees, if called for.

8. The reference is answered accordingly. No costs.

9. Mr. Swamy, learned counsel for the assessees, made an oral application for leave to appeal to the Supreme Court, pointing out that there is a conflict of judicial opinion and it has to be resolved by the Supreme Court. Having regard to all the facts and circumstances, we certify this to be a fit case for grant of leave to appeal to the Supreme Court under section 29(1) of the Wealth-tax Act, 1957.