VALUATION OF SHARES

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APPRAISAL OF SHARES FOR STAMP DUTY, PROBATES AND COURT FEES
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CHAPTER VII

APPRaisal OF SHARES FOR STAMP DUTY
PROBATES AND COURT FEES

01 INTRODUCTION

01.01 Power to prescribe rate of stamp duty in respect of transfer of shares is given in the Union list of the constitution, parliament has, therefore the exclusive power to prescribe the rates of stamp duty on the transfer of shares. The Stamp Act, 1899 (Articles 62) prescribes the levy of stamp duty for the purposes of transfer, whether with or without consideration of shares in an incorporated company or other body corporate.

02 STATUTORY PROVISIONS

02.01 Section 21 of The Stamp Act 1899 provides "where an instrument is chargeable with ad valorem duty in respect of any stock or any marketable or other security, such duty shall be calculated on value of such stock or security according to the average price or the value thereof on the day of the date of the instrument."
02.02 Sec 2(16A) of The Stamp Act 1899 defines marketable security as "a security of such description as to be capable of being sold in any stock market in India or in United Kingdom."

02.03 The rate of stamp duty is provided in Article 62, Schedule I to The Stamp Act 1899. Transfer (whether with or without consideration)

"For every hundred rupees or part thereof of value of the share."

a) "of shares in incorporated company or other body corporate"

02.04 Sec 22 provides that where an instrument contains a statement of average price and is stamped with in accordance/such statement, it shall so far as regard to subject matter of such statement be presumed, until contrary is proved, to be duly stamped.

02.05 Sec 2(46) of The Companies Act, 1956 defines "Share" means "share in the share capital of a company, and includes stock except where a distinction between stock and shares is expressed or implied."
A "marketable Security" denotes a security which is "capable according to the use and practice of stock markets, of being there, sold and bought." This will on one hand, exclude such securities as mortgages on land or proper heritable bonds, but on other hand, will include debentures of companies" (Texas Land Cattle Company v Inland Revenue (1908) Commissioners 16 Court Cases 4th Series, 69, 26 SC L.R. 49. The word security does not necessarily cannot be a mortgage or pledge but rather property. (Sheyer Brothers V Inland Revenue Commissioners (1907) K.B. 246 SC (1908) AC 92. The words used are "of such a description as to be capable of being sold." The test is not whether the security is quoted on a stock exchange or whether there is a market for security in question; it is enough if, having regard to the use and practice of stock markets, the instrument is of such a description that it is capable of being bought and sold in stock markets. (Texas Land

1. Texas Land Cattle Company v Inland Revenue Commissioners 16 Court Cases 4th Series, 69, 26 SC LR 49.

2. Sheyer Brothers v Inland Revenue Commissioners (1907) K.B. 246 CA. (1908) AC 92.
and Cattle Company v. Inland Revenue Commissioner (1888) 16 Court Sess cases 4th series 69, 26 SC L.R. 491, Brown Shipley & Co. v. Inland Revenue Commissioners (1895) 2 Q.B. 5982, Sheyer Brother V Inland Revenue Commissioner (1908) A.C. 923. So, the debentures of a private company containing no provisions objectionable to stock exchange are marketable securities. (Sheyer Brothers v Inland Revenue Commissioner (1908) A.C. 92)3.

03.02 The Stamp Act 1899 does not define stock but the English Stamp Act (54 and 55 Vic; C 39) sec 122 defines it to include any share in any stock or funds transferable at the bank of England or at Ireland and India.

03.03 The Companies Act 1956, inclusive definition defines share as "share includes stock except where a distinction between stock and shares is expressed or implied."

03.04 Thus shares in a company whether private or public is a marketable security under sec. 2(16A) of

1. Taxas Land Cattle Company v. Inland Revenue Commissioners 16 Court cases 4th Series, 69, 26 SC LR 49.
2. Brown Shiply & Co. v. Inland Revenue Commissioners (1895) 2 Q.B. 583.
of The Stamp Act 1899 and is to be valued as provided in section 20 to 22 of the said Act.

03.05 According to article 62, stamp duty is leviable on instrument of transfer of shares with or without consideration. Thus transaction including gift of shares are also covered. The said article has used shares as plural on one occasion and share as singular on other to prescribe the rate per share.

04 VALUATION

04.01 The value of shares in company to be adopted as provided in sec 22 of The Stamp Act 1899 shall be according to the average price or the value thereof on the date of instrument.

04.02 Sec 22 provides for the presumption in favour of what is stated in the instrument as to be the correct value, until contrary is proved.

04.03 The occasion for valuation of shares in a company for Stamp Duty purpose would arise only when presumption inform of correctness as to what is stated in the instrument is challenged. In that event the value is to be ascertained as under:
a) To ascertain the correct average price, or

b) Value

04.04 The first part presupposes that there is an average price of share available. The requirement of drawing an average presupposes the existence of day to day or regular interval quotations or transactions as in the case of shares listed in a stock exchange. Present practice is to levy the stamp duty as per the quotation as on the day on which the transfer form is lodged for the registration of transfer.

04.05 Though ultimately the facts and circumstances of the case, the nature of the company, the prospects of profitability and such other considerations will be taken into account in ascertaining the correct value of shares in case of second alternative. The following principles are normally applicable:

a) Where the shares are of a public 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 if profits are not reflected in the dividends, then one can, on examination of the Balance Sheet, ascertain the profit earning capacity of the concern and, on the basis of potential yield, fix the valuation. 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. 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.

b) Where the dividend yield and earning method break down by reason of the company's inability to earn profits and declare dividends, if the setback is temporary then it is perhaps possible to take the estimate of the value of the shares before setback and discount it by a percentage corresponding to the proportionate fall in the price of quoted shares of companies which have suffered similar reverses.

c) Where the company is ripe for winding up, the breakup value method determines what would be realised by that process.

d) Valuation by reference to the assets would be justified where the
fluctuations of profit and uncertainty of the conditions at the date of the valuation prevent any reasonable estimation of prospective profits and dividends.

04.06 However, the aforesaid rules are no hard and fast rule. But the value, unless in exceptional circumstances, 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.

04.07 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. The yield method is the generally applicable method while the breakup method is the one resorted to in exceptional circumstances or where the company is ripe for liquidation but nonetheless is one of the methods.

04.08 The above principles are given in decision in Mahadev Jalan\(^1\) case was affirmed by Assam and Nagaland High Court in Jalan v CWT (1968) 69 ITR 170\(^2\)

1. CWT v Mahadev Jalan (1976) 86 ITR 621 (SC)
2. Jalan v CWT (1968) 69 ITR 170
and similar view has also been taken in CWT v Executors of the Estate of Sir E.C. Benthal (1980) 121 ITR 814 (Cal.) and these are methods of share valuations applicable which are given in Annexure IV.

05 CONCLUSION

05.01 Though not much of challenging nature, the principles involved in appraising shares in a company for stamp duty purpose involves ascertaining of a value. As the term value is not proceeded by a term market, fair, reasonable; the term is to be understood as defined in Chapter II and rules of valuation as explained above applied.

06 APPRAISAL FOR COURT FEES

06.01 The appraisal principles as explained above are applicable in case of the appraisal of the shares in a company for court fees. For the purpose of Court Fees, if the shares have market value (quoted shares) at the date of presenting the plaint, then such market value will be taken. The difficulty in putting of exact meaning to the term Market Value is already explained in earlier Chapters.

In case of shares which has

1. CWT v Executors of the Estates of Sir EC Benthal (1980) 121 ITR 814 (Cal.)
no market value, the value stated in the plaint is accepted for the purpose of paying the Court Fees. (Section 7(iii) & (iv) (a) of the Court Fees Act 1870). Thus for all practical purposes, the appraisal of share in a company for court fees would be the method of valuation followed by plaintiff and could be any one of the method explained above or in Annexure IV and unless there is likelihood of any challenge thereof. In the event of challenge the principles laid down in para 4.05 herein above shall apply.

07 APPRAISAL OF PROBATES

07.01 When application for grant of probate or administration is made; the probate duty is to be paid on the value of share calculated at its price on the day. The price on the day is not explained, but appears to mean market price as on the day (Section 191 (1) and item (11) of Schedule I of Court Fees Act 1870). In absence of market price appraising on the basis of principles explained in para 4.05 shall prevail and could be calculated as explained in Annexure IV.