VALUATION OF SHARES

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Chapter: IX

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01 INTRODUCTION

01.01 Share prices quoted on various stock exchanges admittedly play a dominant role in determining the valuation of shares of companies whose stocks are actively traded. They also offer a reasonably reliable evidence in respect of valuation of shares of those companies that are not actively traded but belong to company in the same industry.

01.02 But it is a fundamental error, to assume, that the stock exchange "fixes" the price of shares in which it deals. The council of the "stock exchange" London has expressed this important truth as under:

"We desire to state authoritatively that stock exchange quotations are not related directly to the value of a company's assets, or to the amount of its profits and consequently these quotations do not matter what may be chosen for
reference, cannot form a fair and equitable, or rational basis for compensation."

The stock exchange, whether as institution or as a body of individual members, does not determine the prices of which official list is a record. The stock exchange may be linked to a scientific recording instrument which registers, not its own actions and opinions, but the actions and opinions of private and institutional investors all over the country and indeed, the world. These actions and opinions are the result of hope, fear, guess work intelligent or otherwise, good or bad, investment policy, and many other considerations. THE QUOTATIONS THAT RESULT, DEFINITELY DO NOT REPRESENT A VALUATION OF A COMPANY BY REFERENCE TO ITS ASSETS AND ITS EARNING POTENTIAL.

01.03 Thus stock market quotations are result of -
HOPE and/or
FEAR and/or
INTELLIGENT GUESS WORK and/or
UNINTELLIGENT GUESS WORK and/or
GOOD INVESTMENT POLICY and/or
BAD INVESTMENT POLICY
But they do not represent valuation of shares by break up method or by yield method.

Pussl LJ in Hinecheliffe V Carbtree\(^1\) said "that there are many factors - ignorance, optimism, pessimism - that contribute to stock exchange quotations (1971) 2 ALL ER 104.

The Direct Taxes Amendment Act 1989 has sought to give great importance to the stock exchange quotations, for the purposes of valuation of shares of quoted companies, the stock market quotations would be accepted. It has defined quoted shares, unquoted shares and recognised stock exchange and have provided mechanism to ascertain whether the shares are regularly quoted or not.

VALUATION OF QUOTED SHARES

General principle is that the value of shares quoted on recognised stock exchange be accepted for the purposes of valuation. Thus for purposes of fiscal valuation of shares unless contrary is proved the price quoted on stock exchange is taken as the

\(^1\) Hinecheliffe V Carbtree (1971) 2 ALL ER 104.
value of a share. If price on the date of valuation is not available last available price is taken.

02.02 Direct Tax Amendment Act 1989 in Annexure III to the Wealth Tax Act provides for a certificate from the recognised stock exchange in the event of a dispute whether a particular share is regularly quoted or not in a prescribed form.

02.03 The Annexure III to the Wealth Tax Act have not defined specifically how the stock exchange authorities would be in position to issue a certificate that the shares are regularly quoted in the ordinary course of business. It is also further to be noticed that no guidelines so far has been issued in this subject matter. In the past, the approach made by the Income Tax Department in the case of Birla Group of Companies challenging the stock market valuation of the quoted invested companies have not been successful because of the various practical factors involved. The same situation shall prevail even in case where there is suspicion in the mind of the assessing officer that the stock market quotations are not in the ordinary course of business. Thus, it is in the interest of the simplification of the
appraisal process that there should not be any challenge to the stock market value/quotation.

02.04 However for the purpose of computation of income under Income Tax Act, if it is shown that the stock exchange quotations are manipulated the value other than the price may be taken as a fair market value.

02.05 However there is a distinction between the regular quotation and frequent quotation. The term regular cannot be equated with frequent.