VALUATION OF SHARES

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VALUATION OF SHARES (UNDER THE WEALTH TAX ACT)

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CHAPTER X

VALUATION OF SHARES

(En THE WEALTH TAX ACT)

01.01 Section 7 sub section 1 of Wealth Tax Act 1957 (hereinafter referred to as Act) relating to valuation of assets is reproduced in Annexure II. This section prior to its amendment through the Direct Tax Law Amendment Act 1989 embodied the concept of open market valuation. With the amendment through the Direct Tax Laws 1988 now value is to be determined in the manner laid down in Schedule III of the Wealth Tax Act. Thus, from assessment year 1989-90, the provision under Schedule III to the Wealth Tax Act would govern the valuation of various assets for the purpose of levy of wealth tax.

01.02 As indicated hereinabove, the concept of open market valuation is given a go by with the amendment of Sec. 7(1) and now Wealth Tax would be levied on the value of an asset as arrived in accordance with the provisions contained in Schedule III of the Wealth Tax Act 1957. This conceptual change in the valuation principle has henceforth, to a great extent obviated the necessity to
look into the controversies regarding the meaning and nature of open market. Henceforth the Wealth Tax would be levied on a statutory value, if it may be called so, of an asset.

02.01 The approach to valuation of shares in a company under the Wealth Tax Act would require the study to be made under the following heads:

1) Valuation of quoted Equity and Preference shares;

2) Valuation of unquoted Equity shares of companies other than investment companies;

3) Valuation of unquoted Equity shares of the investment companies;

4) Valuation of unquoted Equity shares in inter-locked companies;

5) Valuation of unquoted Preference shares.

03 VALUATION OF QUOTED EQUITY AND PREFERENCE SHARES

03.01 The Rule of Part 'C' of Schedule III provides that value of an Equity share or Preference share in any company which is quoted, shall be taken as the
value quoted on the recognised stock exchange in respect of such share on the valuation date or where there is no such quotation on the valuation date, the quotation on the day close to the valuation date and immediately preceding date.

03.02: This Rule has been amended by the Direct Tax Laws (Second) Amendment Act 1989 by provision of new Rule 9(a) in Part 'C' of Schedule III of Wealth Tax Act. The general rule in rule 9 is that the value of equity share or preference share in any company which is a quoted share shall be taken as the value quoted on the valuation date or where there is no such quotation any date preceding the valuation date which is close. The new rule 9 gives the assessee an option of adopting the average of five years quotation on similar date in the relevant earlier years. The average of less than five years may be taken where the shares has been quoted for five years. This option is to be exercised by furnishing the certificate of such quotation from a qualified accountant with the Income Tax Return.

03.03: The provisions recently introduced as explained above, do not specifically provide as to how/deal with the cases of changes in value occurring due to
effect of declaration of dividend creating cum dividend and ex-dividend quotations; due to effect of declaration of right creating cum-right and ex-right quotations and due to declaration of bonus creating cum-bonus and ex-bonus quotations. It also does not foresee the adjustments that would be required for the import of splitting up or consolidation of shares. However if one goes by the spirit of all the recent amendments i.e. simplification of valuation process and avoidance of prolonged litigations impact of all the factors mentioned herein may be ignored. This is because its impact would be smoothened out due to averaging option or may be limited for one year if averaging option is not exercised/exercisable.

03.04 The definition of equity shares provided in Part 'A' Rule 2(3) defines the equity share as share in the share capital of the company other than the preferential share. This definition, thus, is a definition whereby all shares other than preferential are considered as the equity shares. Whereas the preferential shares are defined as having the same meaning as bound to it in section 85 of the Companies Act 1956 in Part IAI Rule 2(8).
03.05 Part 'A' Rule 2 Clause IX defines quoted shares, meaning the shares which are quoted at a recognised stock exchange as regularly from time to time and quotation of such shares are based on current transactions made in ordinary course of business. The explanation to the Rule provides that where any question arise whether a share is a quoted share or otherwise, within the meaning of this clause, a certificate to that effect furnished by the concerned stock exchange in the prescribed form would be accepted as conclusive. However, no specific guidelines or instructions are issued till date or the prescribed form for the certificate has been provided. It is doubtful whether the recognised stock exchange have a fool-proof mechanism in deciding this vital issue: Whether the quotations are based on current transactions made in the ordinary course of business or not? In absence of the guidelines and the prescribed form, it may be taken that for the purpose of valuation of quoted shares, the quotation listed on the recognised stock exchange may be taken as the value provided in Rule 9 and Rule 9 (a) in Part 'C' of Schedule to the Wealth Tax Act, and the value of the quoted equity shares as well as preferential shares be determined accordingly.
04 EQUITY SHARES (UNQUOTED) OF COMPANIES OTHER THAN INVESTMENT COMPANIES.

04.01 Rule 11 in Part 'C' of Schedule III to the Wealth Tax Act, provided for the valuation of equity shares in companies other than investment companies. This rule which is part of the Act now is substantially the same as the Rule contained in the Wealth Tax Rule prior to its amendment. The Rules as it stood prior to its inclusion in Schedule III and as it now stands as Rule 11 (1), (2) & (3), are reproduced in Annexure II.

04.02 The rules provide for the break-up value method of valuation of shares. For the purpose, there are certain adjustments that are required to be made. They are given in the subsequent paras. But now principle is not to challenge the Balance Sheet value of the assets.

04.03 As per the Rule 2, the value of all the liabilities as shown in the Balance Sheet of a company is required to be deducted from the value of all the assets shown in the Balance Sheet. The net amount so arrived is to be divided by total amount of paid up equity share capital shown in Balance Sheet. The result so arrived is to be multiplied by the paid up value of equity share which would give
break-up value of each unquoted equity shares. To bring the statutory value that would be utilized to levy the Wealth Tax, an amount of 80% of the break-up value so determined is to be taken.

04.04 Rule 11 (3) provides that the Assets of the company would not include:

1) Any amount paid as advance under the Income Tax Act;

2) Net amount shown in the Balance Sheet including the debit balance of Profit and Loss accounts or the Profit and Loss appropriation account which does not represent the value of any asset.

04.05 As regards the liabilities, the same Rule 11 (3) (b) provides that it would not include:

i) paid up capital in respect of equity shares;

ii) the amount set apart for payment of dividend on preferential shares and equity shares where such dividend have not been declared before the valuation date at a General Body Meeting of the company;
iii) reserves by whatever name called other than those set apart towards depreciation;
iv) credit balance of Profit and Loss account;
v) any amount representing provision for taxation other than the actual tax payable on the book profit;
vi) any amount representing dividend liability, other than arrears of dividend payable in respect of cumulative preferential shares.

04.06 For the purpose of Rule II, the Balance Sheet is defined as the Balance Sheet of a company (including the Notes annexed thereto) and forming part of the accounts as drawn on the valuation date and, where there is no such Balance Sheet, the Balance Sheet drawn up on a date immediately preceding the valuation date, and, in absence of both the Balance Sheet drawn up on the date immediately after the valuation date.

04.07 As already stated in para 04.02, studying the above Rules in respect of valuation on unquoted equity shares in the companies other than investment companies, it is to be noted that the principle of valuation by break-up value method is accepted. This method is explained in detail in Annexure IV. The
valuation of all the Assets as reflected in the Balance Sheet is to be accepted and utilised that no other adjustments being necessary in value, except in respect of notes annexed to the balance sheet and forming part thereof.

05 VALUATION OF UNQUOTED EQUITY SHARES OF THE INVESTMENT COMPANIES

05.01 Rule 111 (6) in Part 'A' of Rule 3 to the Wealth Tax Act defines an investment company to mean "A company whose gross total income consist mainly of income which is chargeable to Income Tax under Heads Income from House Property, Capital Gains and Income from Other Source." For the meaning of gross total income, reference is made to Section 80 (b) of Income Tax Act 1961. The scope of the word 'mainly' use of Rule 11 (b) has not so far been defined judicially. The Concise Oxford Dictionary provide the meaning of 'main' as 'chief' in the size or extent, the principle, "most important". The definition of 'investment company' denotes that for each assessment year the major contributors to Gross Total income have to be found out. If the major contribution comes from above named three specified heads, the company is an investment company.
for that assessment year.

05.02 If in the next assessment year, the income from Business or Profession is the major share to Gross Total income for that assessment year, the company will be a non-investment company. Thus the nature of the company is dependent upon the income computed under different heads for each assessment year and it may vary from year to year.

05.03 Rule 12 in Part 'C' of Schedule III to the Wealth Tax Act lays down the mode of valuation of unquoted equity shares in investment companies for the purpose of inclusion in net wealth.

05.03 Rule 12 in Part 'C' of Schedule III of the Wealth Tax Act which is effective from Assessment year 1989-90 is reproduced in Annexure II which contains original Rules. However before going to newly amended and simplified rules let us have an insight to the background of valuation of unquoted equity shares of investment companies in fiscal arena.

05.04 In 1967, in supersession of all earlier instructions for the guidance of Wealth Tax Officers, the CBDT, had in their circular No. 2(WT) of 1967
prescribed the fair market value of the unquoted equity shares of investment companies other than those which are substantially holding companies, as the average of:

a) the break-up value of shares based on the book value of assets and liabilities disclosed in the Balance Sheet, and

b) The capitalised value arrived at by applying a rate of yield of 9% of its maintainable profit. The maintainable profit of a company are to be calculated as under:

i) The book profits of the company for five years immediately preceding the valuation date will be ascertained.

ii) Adjustment will be made to the book profit of each of the said five years for all non-recurring and extraordinary items and income and expenditure and loss.

iii) Adjustment will be made for expenditure which is not of a revenue nature and is
debited in the accounts and for receipts which are revenue receipts and are not accounted for in the Profit and Loss accounts.

iv) Development rebate in case it is debited in the books of account, will be added back.

v) Appropriate tax liability of the company on the book profits so determined will be deducted.

vi) The profit required for paying dividends on shares with prior rights i.e. preference shares, shall be excluded.

vii) The average of company's book profits, as adjusted above, will be determined.

viii) The maintainable profits thus arrived will be capitalised as stated above by adopting 9% rate of capitalisation.

05.05 The Supreme Court in the case of CWT Vs Mahadeo Jalan & others (1972) 86 ITR 621 (SC), September (1972)\(^1\) considered the valuation of the

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1. CWT Vs Mahadeo Jalan & others (1972) 86 ITR 621 (SC), Sept. (1972).
shares in private limited companies on yield basis in relation to assessment years 1957-58 and 1958-59 and evolved the following principles as normally applicable:

1) Where the shares are of a public company which are not quoted on a stock exchange or of a private company, their value is determined by reference to the dividends, if any, reflecting the profit-earning capacity on a reasonable commercial basis. But if the profits are not reflected in the dividends which are declared and a low earning yield is shown by the company, which is unrealistic on a consideration of the financial affairs disclosed for the relevant year, the Wealth Tax Officer can, on an examination of the Balance Sheet, ascertain the profit-earning capacity of the concern and, on the basis of the potential yield fix the valuation. 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. 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 the profits.

2) In the case of a private company also where the expenses are incurred out of all proportions to the commercial venture, they will be added to the profits of the company in computing the yield.

3) Where the dividend yield and earning method break down by reason of the company's inability to earn profits and declare dividends, if the set-back is temporary then it is perhaps possible to take the estimate of the value of the shares before set-back and discount it by a percentage corresponding to the proportionate fall in the price of quoted shares of companies which have suffered similar reverses.
4) Where the company is ripe for winding up then the break-up value determines which would be realised by that process.

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

05.06 While laying down the above principles, the Supreme Court had cautioned that what had been laid down by them were not hard and fast rules because ultimately the facts and circumstances of each case, the nature of the business, the prospects of profitability and such other considerations will have to be taken into account as will be applicable to the facts of each case. The Central Board of Direct Taxes instructions of October, 1967 regarding valuation of shares had not, however, been referred to and commented upon in the decision by the Supreme Court.

05.07 In the case of CGT Vs Smt. Kusumber D. Mahadevia (1980) 122 ITR 38 (SC) \(^1\) the Supreme Court

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again considered exhaustively the question of valuation of ordinary shares in an investment (private) company for the purposes of gift-tax and wealth tax. The Tribunal canvassed the profit-earning method whereas the department of revenue relied on the mean of profit-earning method and the break-up method. While holding that a combination of the two methods cannot be accepted as a valid principle of valuation of shares, the Supreme Court approved the profit-earning method as the only method that could be applied in the case. The Supreme Court, following its earlier decision in the case of Mahadeo Jalan (1972) 86 ITR 621 (SC)\(^1\) developed the following principles:

a) 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 reasonable commercial basis, but if it is found

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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 figures 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 have to be adjusted in order to arrive at the real profit-earning capacity of the company.

b) In the case of a company which is a going concern and whose shares are not quoted on the stock exchange, the profits which the company has been making and should be capable of making, or in other words, the profit-earning capacity of the company would ordinarily determine the value of its shares. The break-up value would not be appropriate for valuation of shares of such a company because among the factors which govern the consideration of the buyer and the seller where one desires to purchase and the other wishes to sell, the factor of break-up-value as on liquidation hardly enters into consideration where the shares are of a going concern.

c) It is only where a company is ripe for winding up or the situation is such that the fluctuations of profits and uncertainty
of conditions at the date of valuation prevent any reasonable estimation of the profit-earning capacity of the company, that the valuation by the break-up method would be justified.

d) What the Supreme Court meant when it said in the case of Mahadeo Jalan (1972) 86 ITR 621 (SC)\(^1\) that, in the case of an investment company, the asset-Backing is a relevant factor in determining the value of its shares was, that in order to determine the capacity of the company to maintain its profits the asset-Backing could be a relevant consideration. The profit-earning capacity of the company would naturally have to take into account not only the profits which the company is actually making but also the profits which the company should be capable of making in order to arrive at a proper estimate of the latter, the asset-Backing would be a relevant factor in the case of an investment company. It is not correct to read

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1. CWT V Mahadeo Jalan (1972) 86 ITR 621 (SC)
the observation as suggesting that valuation of the assets would be a relevant factor in determining the valuation of the shares.

e) In this case also, the validity or otherwise of the Board's instructions of October, 1967 did not come up for consideration.

05.08 The Board's instructions of October, 1967, was criticised on the ground that where the Balance Sheet of an investment company reflected the true market value of its investment and other assets or their market value could be ascertained, the non-adoption of the market values or where the break-up value itself was more than the average value computed under the special method prescribed in the circular, ibid, the adoption of average value would be detrimental to the revenue. The following 'note' in the file of Central Board of Direct Taxes, however, justified (July/August 1978) the instructions:

"It may not be out of place to mention that the intention of the circular dated 31st October, 1967 does not appear to be any

different from what it actually conveys. A reference to file No. 2/2/65/-WT would show that a lot of study, effort and research work went into the relevant exercise before the said circular dated 31st October, 1967 was finalised and that too after eliciting public opinion on the point. The intention behind issuing the said circular was to appreciate the value of the unquoted shares of various categories of companies (investment companies being one of the categories) to those of the public limited companies. For this purpose, the Balance Sheet of a few well-known public limited companies were studied and the break-up value of their shares ascertained therefrom and compared with their market quotations, with a view to finding out the proportion which the market quotation bore to the break-up value of their respective shares. The idea was that the average proportion of the market value of these shares and their break-up value ascertained from this study would be adopted as the basis for the valuation
of unquoted shares of the companies. The circular which originated from the idea was ultimately issued in its existing form after taking into consideration the various relevant factors which came to notice during the course of study on this issue. In light of the matter, it appears that it was always intended that only circular dated 31st October, 1967 should be applied while valuing the shares of such companies."

05.09 In fact, Study Group set up by the Central Board of Direct Taxes for study of various problems arising in the valuation of unquoted equity shares of companies for the purposes of wealth-tax, and those of investment companies in particular, made the following findings/recommendations (vide note dated 2nd August, 1978 in the Central Board of Direct Taxes file):

1) "The objection underlying the procedure laid down in the Circular No.2-WT of 1967 are considerably higher than the market prices as reflected in the

quotations of prices of equity shares of such companies in stock exchanges.

ii) The objection underlying the procedure laid down in the Circular No. 2 (WT) of 1967 of valuing unquoted equity shares of an investment company at the mean of the value of net assets of the company and the capitalised value of its maintainable profits, is to adjust the capitalised value aforesaid to the assets backing of the shares. This method combines the advantages of simplicity and uniformity with the broad fairness of approach.

iii) The value of the net assets of the company should be worked out after making further adjustments as enumerated in para .......

iv) It will not be desirable or practicable to adopt the market price basis in evaluating the assets of an investment company.

v) The rate of capitalisation should be taken at 10 per cent of the maintainable
yield from the company. However, the rate of capitalisation of the maintainable yield in the case of an investment company which derives the major part of the income from house property shall be 8.5 per cent."

(vide para 2.14 of PAC's 147th Report1; 1978-79; of 30th April, 1979.)

05.10 In para 2.17 of their 147th Report1 referred to above, the Public Accounts Committee (chaired by Shri PV Narasimha Rao) made the following recommendation:

"Audit has pointed out that non-adoption of market values, or the adoption of average value where the break-up value itself is more than the average value computed under the instructions of October, 1967, would be detrimental to revenue. The Committee feel that the market price worked out by the method of 'average' will be largely notional and in many cases it may well be much below the 'open market price'. For

example, in the instant case pointed out in the Audit para. the equity shares held by the assessee in an investment company were valued, in accordance with the instruction of October, 1967, at Rs. 485 and Rs. 484 per share for the assessment years 1973-74 and 1974-75 respectively. Whereas the break-up value of shares based on the book value of the assets of the company was Rs. 1,165 per share for these assessment years. Thus, in certain cases, the application of instructions of October, 1967 may have the effect of valuation, for the purpose of Wealth-tax, at a level substantially lower than the value admitted by the assessee himself in the Balance Sheet. This is clearly to the detriment of revenue and against the spirit of section 7(1) of the Act. The Committee would not like to hazard a definite suggestion as to how the valuation should actually be done. The Committee would, however, like the Department to re-examine the method of
valuation of unquoted equity shares of investment companies and if necessary, amend it suitably so as to safeguard the interest of revenue."

05.11 In their action taken note of 11th March, 1981, the Department of Revenue had stated that proposals for notification of fresh rules for valuation of shares are under consideration of Government. In para 1.8 of their 58th Report (1981-82; date of presentation to Lok Sabha: 18 Sept., 1981), the PAC further recommended as under:

"In the 147th Report (Sixth Lok Sabha), Public Accounts Committee had pointed out that there was no rule under the Wealth-tax Act, 1957 providing for the manner in which the market value of unquoted shares of an investment company was to be determined. The Committee had further pointed out that the circular No.2 (WT) dated 31st October, 1967 could in certain cases be detrimental to revenue. The Committee had therefore desired the Department of

Revenue to frame rules in this regard and notify it at the earliest so as to provide a legal basis to the procedure of valuation of unquoted shares of investment companies. The Committee have now been informed that proposals for notification of fresh rules for valuation of shares are under consideration of the Government. The Committee would like the matter to be expedited and the final decision taken in this regard intimated to them."

05.12 A company may own assets which are (i) specific to its activities and which cannot be dispensed with, such as plant and machinery and buildings particular to the manufacturing activities of a company; and (ii) non-specific and easily realisable assets, such as investments in other companies and in real property. Excess of the market value of nonspecific and realisable assets of a company over their book value is a "Secret reserve." In regard to treatment of such assets for purposes of valuation of shares of the companies, the Public Accounts Committee was concerned about (a) the same treatment given to the two types of assets of a company and (b) the
instructions of the Central Board of Direct Taxes not taking into account the secret reserves while computing break-up value of unquoted Equity shares and (c) ignoring the secret reserves especially where the companies are family controlled (Paras 4.18 and 4.19 of PAC's 51st Report (1980-81; presented in Lok Sabha on 30th April, 1981)¹. The Ministry in their reply of November, 1981 drew the attention of the Public Accounts Committee to draft the rules in regard to valuation of shares published on 29th August, 1981 for finding out the public reaction. The proposed rule in regard to valuation of unquoted shares of investment companies read as under:

Valuation of unquoted equity shares of investment companies:

I-E(i) for the purpose of sub-section (1) of section 7, the valuation of an unquoted equity share of an investment company shall be determined in the following manner, namely:

1) the value of all the liabilities including such liabilities which are not reflected in the balance sheet of the

company shall be deducted from the value of all its assets which they would fetch if sold in the market on the valuation date, or in case any rules are made for the valuation of any asset, the value so determined in accordance with such rule;

ii) The net amount as arrived at in accordance with clause (i) shall be divided by the total amount of its paid-up equity share capital as shown in the balance sheet;

iii) the amount as arrived at in accordance with clause (ii) as multiplied by the paid-up value of each equity share shall be the value of the unquoted equity share of an investment company.

(2) Nothing contained in this rule shall apply to any assessment year commencing before the 1st day of April, 1982.

Explanation: For the purpose of rule 10 and this rule, where the quotation in respect of any equity share on a recognised stock
exchange in India, is found to be less than two thirds of the value arrived at in accordance with the provision of rule 1D or this rule, as the case may be, such a share shall be deemed to be an unquoted share."

05.13 The question of valuation of unquoted equity shares of investment companies engaged the attention of the Public Accounts Committee again in January, 1982. While giving evidence before the Committee, the Chairman, Central Board of Direct Taxes testified that -

(i) of the two methods, capitalisation of the yield method was better than the break-up value method;

(ii) however, in view of the practical difficulties involved not only in determining the yield but also the maintainable profits in such cases, the Departmental Committee (1976) favoured prescribing the break-up method; and

(iii) it was found in actual working that the break-up method resulted in very low valuation in certain cases and also led to rigging of shares.
(Para 3.118 of PAC's 101st Report (1981-82); April, 1982). Despite the Supreme Court's decision in Mahadeo Jalan's case and Kusumber D. Mahadevia case the Central Board of Direct Taxes asserted that preference is shown to break-up method of valuing the assets, in certain circumstances, the break-up method could also be resorted. While recommending for the early finalisation of the draft rules already published for eliciting public comments, the Committee stated, that common rules consistent with the provisions of the three Acts namely the Wealth Tax Act, the Gift Tax Act and the Estate Duty Act (since abolished) should be framed so as to ensure that different values are not assigned to the same shares for the purposes of the three different taxes at the same time (vide para 3.119 of the PAC Report ibid).

05.14 In April 1984, again the Public Accounts Committee was seized of the question of valuation of unquoted equity shares of companies while discussing a paragraph in the Report of the Comptroller & Auditor General of India for the year 1980-81. The Committee opined that the new rules for valuation as

and when framed, would take due care of not only the hidden reserves of private companies but also of other loopholes contributing to considerable under-valuation. While observing that the valuation should be based on the yield method, the Public Accounts Committee also suggested that since the yield can be deliberately suppressed and reserves can be accumulated by a private company without declaring dividends, the law and the rules would have to provide for correct valuation in such a case also (vide PAC's 203rd Report; 1983-84; 7th Lok Sabha; 1984 April)1.

05.15 In April 1986, the Finance Ministry had through a notification invited objections or suggestions on the proposed Wealth Tax (Amendment) Rules, 1986, which proposed inter-alia, Rule 1-E for determining the market value of an unquoted equity share of an investment company. The Rule read as under:

1-E Market value of unquoted equity shares of investment companies.

1. The market value of an unquoted equity share of an investment company shall be determined as follows:

The value of all the liabilities as shown in the Balance Sheet of such company shall be deducted from the value of all its assets shown in that balance sheet. The market value of each equity share shall be its paid-up value multiplied by the factor arrived at by dividing the net amount so arrived by the total paid up capital of the company.

2. For the purposes of sub-rule (1), the value of an asset disclosed in the balance sheet shall be taken to be its value determined in accordance with the rule as applicable to that particular asset and in the absence of such a rule the price which the asset will fetch if sold in the open market on the valuation date.

Explanation - for the purposes of this rule -

a) The expression 'balance sheet' has the same meaning as in Explanation 1 to rule 1-D.
b) The amounts referred to in Explanation II to Rule 1-D shall not be treated as assets or liabilities.

05.16 Though it was contemplated that the rule was to be brought into operation from 1st April, 1987, the rule with minor modifications have been included in the Direct Tax Laws Amendment Act, 1988 to take effect from 1st April, 1989. Instead of incorporating the valuation rules in the Wealth-tax Rules, they have been brought into the Act itself as Schedule III.

05.17 A note-worthy amendment is effected in Rule 12 in Part 'C' of Schedule 3 to the Wealth Tax Act by the Taxation (Second Amendment) Act, 1989. This noteworthy amendment omits sub-rule (3) & (5) from Rule 12 relating to the valuation of unquoted equity shares in the investment companies. Sub Rule 3 required each disclosed asset to be valued separately under the relevant rules or if there is no such rule under residuary Rule 20. This is now done away with, as a corollary, the burden cast on company to furnish the valuation to the Assessment Officer has also been removed. The major criticism against the new Rules is that it runs counter to the principles of
valuation enunciated by the Supreme Court in the two case laws Mahadeo Jalan and Kusumber Mahadevia. According to the Supreme Court, only suitable method of share valuing of a going concern is the yield capitalisation method. On unquoted shares, if one has got to pay Tax on imaginary values fixed arbitrarily, as is in the case when the valuation is based on break-up value arrived separately for each asset, the levy is going to be exhorbitant. For about two decades, 1967, the value of unquoted equity shares of investment companies was based on average break-up value determined adopting the book value of assets and liabilities and the capitalised value accepting a yield of 9% of its maintainable profits. The introduction of the concept of break-up value would enhance the burden of levy. However, as the law now stands, the value of the equity shares of an investment company, is to be determined by the same method as that of the value of unquoted equity shares of a company other than the investment company.

06.01 Explanation to Rule XIII in part 'C' of Schedule 3 to the Wealth Tax defines the 'inter-
locked companies meaning two investment companies holding shares in each other. Rule XIII provides for the valuation of unquoted equity shares. The value of an unquoted equity share in one of the two interlocked companies held by the other interlocked company for the purpose of Rule 12, shall be equal to the paid up value of such share or the value determined under sub Rule 2.

06.02 In accordance with sub Rule 2, the value of equity share in an inter-locked company is to be arrived by multiplying the maintainable profit of such company by (a) fraction of 100 divided by 8.5 in a case where gross total income of the company consist to the extent of not less than 51% of the income chargeable under the head Income from House property or (b) the fraction 100 divided by 10 in case of any other inter-locked company and the resulted amount divided by the number of such equity shares shall be the value of such an equity share in such company.

06.03 The maintainable profit of a company is to be computed in the following manner:

a) The book profits of a company for five
accounting years of the company immediately preceding the valuation date shall first be ascertained.

b) Adjustment shall be made to the book profits for each of the five years for all non-recurring and extra-ordinary items of income and expenditure and losses.

c) Adjustment shall be made to the book profits for expenditure which is not of a revenue nature but is debited in the account and for receipts which are in the nature of revenue receipts but are not accounted for in the Profit and Loss account. Any development rebate or investment allowance debited in the books of account shall be added back to the book profit.

d) The tax liability of the company on the book profit arrived after above adjustments, shall be deducted from such book profits.

e) Amounts required for paying dividends on preferential shares or shares with prior
rights shall be deducted from such profits.

f) Aggregate of book profit for five accounting years so arrived, shall be the maintainable profit of the company.

06.04 In other words, the value of unquoted equity shares of an inter-locked company is to be determined on the basis of yield method. However, in view of the amendment in rule XII in Para 'C' of Schedule III of the Wealth Tax Act by deletion of Sub-rule 3, it is doubtful in what way these rules would be practically implementable.

07 VALUE OF UNQUOTED PREFERENTIAL SHARES

07.01 For the purpose of valuation of unquoted preference shares, Rule 10 in Part 'C' of Schedule III to the Wealth Tax Act makes the necessary provision. The provisions makes a distinction between the preference shares having a rate of dividend not less than 8% and rate of dividend less than 8%. The Rules provided a separate approach to the valuation in both the cases. The Rule 10 (2) provides that where in any company preference dividend has not been paid in respect of unquoted preference shares continuously for not less than three accounting years ending on the valuation date or in a case where
accounting year of a company, does not end on the valuation date for not less than three continuous accounting years ending on a date immediately before the valuation date, the paid up value or the adjusted paid up value as the case may be, is to be reduced. For the purpose of reduction, the Rules make a distinction between the cumulative and non-cumulative nature of preferential shares. The table is given in Annexure III.

07.02 The Rules also define the adjusted paid up value as an amount which bears the relation to paid up value of preferential shares in the same proportion as the specified rate of dividend (being a rate of dividend on the preferential share specified in terms of issue of such share), and in case such dividend is required to be increased under provision of Section 3 of the Preferential Shares (Regulation of Dividend) at 1960, the rate of dividend (as increase) on such share bears at the rate of 8%.

08 CONCLUSION

08.01 The amendment effected in the various Rules for valuation under Wealth-tax Act indicates the realisation on the part of revenue that the simplification of the rules would enable the authorities
to concentrate more on important matters rather than
cumbersome exercise of arrival at the market value
of the Asset. It is a bold approach and needs to
be commended. It has simplified the task of
appraiser.

09 GIFT TAX

09.01 The Taxation Law Amendment Act, 1989, by
amending Section 6 of the Gift Tax Act 1958 and
stipulating that the value of Gift shall be deter­
mined in the manner laid down in Schedule 2 of the
Act, which is reproduced as Annexure III. The same
Schedule however, laid down that the provisions of
Schedule 3 to the Wealth Tax Act shall apply in
regard to valuation of any property other than cash.
In other words, the valuation basis both for Wealth
Tax and Gift Tax has now been made uniform. Thus,
all the provisions discussed hereinabove in respect
of valuation of shares in a company under the
Wealth Tax Act pari materia applies to the valuation
under the Gift Tax Act.

10 CAPITAL TRANSFER TAX

10.01 In India so far there was no provision for
levy of Transfer Tax on property inherited by a person on
death. The Wealth Inheritance Act 1989 makes a provision in this regard. This Act is in lieu of Estate Duty that has been abolished since 16.3.1985.

10.02 The approach of the bills are same to the Capital Transfer Tax of U.K. According to Section 8 Sub-section I of Wealth (Inheritance Duty) Act 1989, the value of the property will have to be determined as on the date of death in accordance with the provisions laid down in Schedule II of the Act. The Schedule II of the Act refers to Schedule III of the Wealth Tax Act, and hence valuation of shares in a company for the purpose of this Act has to be done in accordance with the discussions made out hereinabove.

11 ESTATE DUTY

11.01 The provisions of Estate Duty has been suspended with effect from 16.3.1985 and hence the valuation of shares for the purpose being only for academic interest, are not discussed.