FAIR VALUE OF SHARES

1. INTRODUCTION: Everyone interested with the valuation of company shares is most concerned about the ascertainment of the fair value of shares. To a valuer, it is the target to be achieved; to a seller, it is the expectation to be fulfilled; to a buyer, it is satisfaction to be obtained and to the taxing authorities, it is the appropriate measure for imposition of taxes. Fair value imparts a healing touch of fair treatment to all parties interested in the valuation of shares and any other property. It is in this context that the discussion on fair value of shares has been considered to be a part and parcel of the discussion on valuation of company shares in India. Fair value of a share may be said to be that estimate of the value of the share which is fair and reasonable to all concerned, due weight being given to all important considerations.

Simple definition of fair value

Fair value is the just and equitable price which a well-informed buyer, acting voluntarily and intelligently, would be prepared to pay, if he were acquiring the shares for
investment or for any other type of productive use. In the view of the Research Committee of the Institute of Chartered Accountants of India, "In theory, the fair value of a share is equal to the present worth of the future dividends which will be received by its holder."  

2. **POPULAR CONCEPTIONS OF FAIR VALUE**

As regards fair value, there are two types of popular conceptions. One is the statutory conception of fair value of shares, i.e. the idea of fair value of shares as enunciated in Indian direct taxation and other statutes and the other is the non-statutory conception of fair value of shares, i.e. the general notion of fair value as recognised by non-statutory circles.

(a) **Statutory conception of fair value**:

The statutory conception of fair value of shares is available from direct taxation statutes and from some other statutes which deal with shares and their valuation.

(i) **Direct taxation statutes**:

The tax valuation under direct taxation statutes refer to "open market price" and "fair market value". The open market concept of value has been postulated as the basic general principle of valuation of shares under three direct
taxation statutes, namely, the Estate Duty Act, 1953s the Wealth-Tax Act, 1957 and the Gift-tax Act, 1958. The relevant provisions of these Acts enunciating the open market concept have already been discussed in an earlier chapter. The question as to whether open market value can be considered as fair value has also been discussed in that chapter. It has been established that a value estimated in a hypothetical open market between a willing buyer and a willing seller is considered to be the fair value of the shares. Many courts have declared the open market value to be a fair estimate of the value of any property on the ground that a price realised in an open and unrestricted market under the reasonable competitive conditions can be taken to be the just and equitable price of the property. The scope of judicial review of the estimate of value in an open market acts as a check on the authority concerned.

A controversy as to fair value under direct taxation statutes has been raised because of the reference to 'fair market value' in one of the direct taxation statutes. Fair market value has been referred to in sections 52 and 55 read with section 2(22A) of the Income-tax Act, 1961 in connection with the assessment of capital gains. The provisions of these sections together
The concept of fair market value and its affinity with the open market concept enunciated in other direct taxation statutes have already been discussed.

The discerning reader will note that while under the Estate Duty Act, the Wealth-tax Act and the Gift-tax Act the value of a share shall be estimated to be the price which it would fetch if sold in the open market, the value of a share for the purpose of the Income-Tax Act shall be the price which it would ordinarily fetch on sale in the open market. The concept of open market governs the valuation of shares in all the direct taxation statutes. But under the Income Tax Act, the word used is "ordinarily". In case of other direct tax laws, the word "ordinarily" is absent. Two relevant questions need answering here. The first question is, what is the special significance of the word, "ordinarily"? The second question is, whether the word has created a vital difference between open market value and the fair market value.

In tax valuation the normal concept is open market price. But when the word "ordinarily", has been used, the presumption is that the legislature intended to make slight but very important difference between the normal basis of valuation and the basis
advocated in the Income-tax Act. This presumption is based on the principle of interpretation of statutes that an appropriate meaning has to be given to the words used in the statute.

Significance of the word, "ordinarily", because the legislature must have used the words with a definite purpose. In this perspective, the word "ordinarily", used in section 2(22A) of the Income-tax Act assumes special significance. It is not an accidental addition to the section. Instead, the word has been used with a definite intent and purpose.

The special significance of the word, "ordinarily", lies in the fact that for the purpose of computing capital gains, the taxing authority will have to take into consideration the realities of the situations, the facts and circumstances of the particular case. The value of the shares concerned can not be determined solely on some assumptions or notional estimates. The word puts some restrictions on the freedom of the taxing authorities to value the shares on a purely estimated basis. When an actual sale of shares takes place, the price realised may not reflect the fair market value i.e. the price which the shares would fetch in an open market according to the current market price of comparable securities. The sale may be under distress conditions or under some abnormal or difficult situations which may be responsible for the realisation of lesser
prices. The word "ordinarily", suggests that the value of the shares sold is subject to restrictions and potentialities affecting the value of the shares. It guides the authorities concerned to adopt a real or pragmatic approach on the actual recorded price of shares.

So far as the answer to the second question is concerned, it may be said that the word was perhaps, meant for slight but very vital difference between open market value and fair market value. The concept of open market price signifies that the valuation is to be based on a hypothetical sale between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having a reasonable knowledge of relevant facts. Fair market price means the price which a particular property would fetch in an open market according to current market price comparable to other sales of the same type of property. The word, "ordinarily" in the definition of fair market value signals that the open market price is subject to restrictions, limitations, advantages or disadvantages on actual sale in the open market.
The difference between the fair market value and the open market price lies in their respective approaches to valuation.

Open market price and fair market value - approach to valuation different?

In the case of valuation on the basis of fair market price, the approach is a real approach based on the actual recorded price realised with the only pre-condition that before accepting the said recorded price as evidence of fair market value, necessary corrections may be required in such recorded price, if it does not reconcile with fair market considerations.

The whole idea behind the ascertainment of fair market value on the basis of the adjusted recorded price, is to adopt a realistic attitude towards valuation. In the case of open market price, the sale is hypothetical in an open market. The stretch on the 'theory of oughtness' is too far and so much that one may land in the world of fantasy.

Is it possible to make a sharp distinction between open market value and fair market value?

In practice, however, it is difficult to draw a sharp line of distinction between the two concepts. Both the concepts have the objective of arriving at the value of shares which is fair from all considerations.
(ii) Other statutes requiring valuation of shares -

Apart from the direct taxation statutes, other statutes requiring valuation of shares e.g. The Indian Stamp Act, The Court Fees Act and The Companies Act have not specifically referred to either open market value or fair market value. Instead these statutes have generally referred to market value or market price of the shares. Section 21 of the Indian Stamp Act which lays down the principles of determining the value of stock and marketable or other securities has referred to the average price or value. The Act has given no meaning of the term, "average price or value". Therefore, the term is taken, in judicial circles, in its natural meaning which is the average market price or value. Section 7 of the Court Fees Act has referred to the market value of shares. The Companies Act has referred to market value of shares under section 108B(3).

It will now appear that whereas some statutes have referred to open market value, others have referred to fair market value and still some other statutes have mentioned market value or market price. It may be argued that the distinction between open market value and fair market value under the direct taxation statutes has been made by the inclusion
Is it possible to make a distinction among open market value, fair market value and market value under the Income-tax Act? Then again the term, "fair market value", signifies that there may be a market value which is unfair and when the fair market value is computed, the unfair market value is automatically excluded. In tax valuations it is generally thought that the adjective "fair", against market value visualises a value which is unfair either for the revenue or for the tax-payer. The judicial gloss on the adjective "fair", indicates a value which is fair as between the revenue and the tax-payer. It is also suggested that "the main purpose of putting the adjective "fair" before the term "market value" is to introduce an element of hypothetical market with willing buyers and willing sellers to guard against forced sales or such other sales, transactions, transfers etc. at abnormally low prices and at the same time it may also exclude assessment of properties for taxation purpose at inflated boom prices."

However, it will appear from a close study of the court decisions on valuation that the judges have felt it unnecessary to make a distinction between market value and fair market value or between fair market value and open market value. Instead they have frequently used the terms market value and fair market value as exact synonyms. In some cases, the term
"market value" has been used, while in others use has been made of the expression "fair market value". No court has ever discarded a properly estimated open market value to be unfair and unjustified. Whatever may be the terms used, the courts have seen to it that the attribute of "fairness" is imported into the term. It appears, therefore, that the main concern of the judges lies in the fixation of a fair or just value and not in the terminology used in a particular statute or in a particular plaint.

(b) Non-statutory conception of fair value:

Fair market value, open market value and market value enunciated in various direct taxation and other statutes are not the only bases of valuation of shares of companies. Many private agreements and company articles may provide for the determination of a "fair value" to be certified by the auditors.

(i) Private agreements:

In some cases, Private agreements between the parties may provide that a transfer of shares will take place at a value to be mutually agreed upon between the parties. A value mutually agreed upon between the interested parties up to their own satisfaction after
Mutually agreed value as fair value a proper consideration of all relevant facts and circumstances and not for
gift or natural love and affection or for any irrational and unjust consideration, can not be termed as unfair. The parties to a mutual agreement are expected to be prudent, well informed and alert about the protection of their own interests. Statutory recognition to the mutually agreed values of shares has been accorded by Explanation to section 108-B(3) of the Companies Act.

(ii) Valuation as per articles of association

Sometimes articles of association provide clues for valuation of shares. Under the articles, the onus of fixing the value may be thrown upon the company in general meeting or upon the auditor.

Some ancient articles provided for the fixation of the value of shares by members at each annual general meeting. Such value can not be termed as "fair value", for the following reasons:

(1) Few members of the company are capable of forming an intelligent opinion on such a difficult matter as share valuation, so that there is a danger of automatic fixation of value of shares.
(2) Value fixed by general meeting may be considerably below real value, because a controlling faction of shareholders desires to buy the shares meant for sale at a very low price. No motivated valuation can be called a fair valuation.

(3) There is also a danger of fixation of the value of shares in a haphazard way without due consideration of the factors influencing the valuation of shares.

(4) Absence of purpose orientation in Periodical valuation at the annual general meeting steals much of the fragrance of fair value.

Some articles provide for the fixation of the value of shares by auditors. In Dean Vs. Prince, the articles of the company provided for the fixation of a value of shares to be certified by the auditor. In A.G. of Cylon Vs. Mackie the articles contained a provision for the fixation of a fair value by the auditors. Dean Vs. Prince is one of the most celebrated cases in share valuation in which the auditor's valuation of shares was upheld by court. There is no reason why auditor's valuation may be called unfair particularly when the auditors have enough
scope and intelligence to form an expert opinion on the appropriate value of shares under the facts and circumstances of the particular case. R.L. Sidey expressed his opinion in favour of fixation of fair value by the auditors of a company. Independence and impartiality coupled with expert knowledge and vast experience, can help the auditor to fix a reasonable value of shares for all the interested parties.

(c) Acceptability of the statutory and non-statutory conceptions of fair value. There is no way out to avoid the statutory conception of value in cases where shares are required to be valued under certain statutes. It has been explained that the concept of open market value, fair market value or market value enunciated in various statutes is meant for determining a value which will be considered to be fair both for the revenue and for the tax-payer. Carefully conceived and properly applied, the statutory methods are capable of resolving the problem of determining the fair value of shares. Moreover, it is now firmly established in judicial circles that statutory methods are meant for fixing a fair value, that is a value which is fair as between the tax-payer and the revenue.

Unfortunately, there are still certain unscientific principles of valuation of shares in one or two statutes. For example, Wealth-tax Rules provide for...
a set of un-scientific principles for the valuation of shares which do not even have the advantage of clarity."

Some doubts may arise as to the acceptability and binding force of the non-statutory conception of fair value. Generally a value determined by the auditors under the articles of association of a company or a value determined by expert valuers under an agreement is binding on the parties in the absence of negligence, fraud, mistake or miscarriage of the valuer has

exercised his discretion and judgment properly in light of all the circumstances to arrive at a value which is fair to all parties, his decision is bound to have the

Limitations on the acceptability of expert valuation. In the case of Collier vs. Mason, the Master of the Rolls made the following comments on a valuation dispute: -

"It is not proved that Mr. Singlehart (the valuer) did not exercise his judgment and discretion in the best way he could. It may have been improvident as between these parties to enter into a contract to buy and sell property at a price to be fixed by another person, but that cannot avoid the contract. Here the referee has fixed the price, which is said to be evidence of miscarriage, but this court, .................must act on that valuation, unless there be proof of some mistake, or some improper motive, I do not say a fraudulent one; as if the valuer had valued something not included, or had valued it on a wholly erroneous principle, or had desired to injure one of the parties
to the contract; or even, in the absence of any proof of any of these things, if the price was so excessive or so small as to be explainable by reference to some such cause; in any of these cases the court would refuse to act on the valuation......

Thus, in the absence of an evidence of fraud, mistake or miscarriage, an objective and honest estimation of value of shares made by an expert valuer on the basis of sound and accepted principles of valuation and not by using short-cut devices provided by over-simplified formula is always acceptable as an instance of fair value of shares. The point is that the estimation of fair value should be judiciously and analytically made with sound reasons and should not be arbitrary or capricious or fraudulent. If, however, the valuation is affected by a material mistake committed by the valuer, it may have to be revised.

"......if a valuation is erroneous in principle it is vitiated and cannot be relied on......"

In the case of Dean Vs. Prince, the High Court held that the valuation of shares made by the auditor is not binding on the parties. Harman, J., stated:

"......It is true that the auditors are dealing as experts and that they have to arrive at what is their opinion about the fair value. It may well be that their opinion, although wrong in the eyes of the others, may prevail, but if they had founded themselves on an entirely wrong basis and have chosen to explain that basis I cannot see that the provisions of Article 9(g) of the company's articles preclude the plaintiff from attacking it."
However, in the Court of Appeal, the three judges disagreed with Hannan, J., and upheld the auditor's valuation. But the following comments were made with regard to the valuer's mistakes.

Sir Raymond Evershed, M.R. said:

"I think the plaintiff is prima facie entitled to succeed if she is able to show that Mr. Jenkinson, in arriving at his figure of \$7 per share, make a mistake of a substantial character or materially misdirected himself in the course of his valuation............" 16A

Denning, L.J. said:

"It (the valuation) can be impeached, not only for fraud, but also for mistake or miscarriage........For instance, if the expert added up his figures wrongly, or took something into accounts which he ought not to have taken into account, or conversely, or interpreted the agreement wrongly, or proceeded on some erroneous principle—in all these cases the court will interfere........On matters of opinion, the courts will not interfere, but for mistake of jurisdiction or of principle, and for mistake of law, including interpretation of documents, and for miscarriage of justice, the courts will interfere." 16A

Thus, the general principle of impeachment of a valuation of shares by an expert is that the valuer's mistake must be material. An immaterial error does not vitiate a valuation. 17

In Dean Vs. Prince, Sir Raymond Evershed, M.R. said:
"The possibility of occasional error is common to all men, to whatever profession they may belong."

On the whole, so far as the acceptability of non-statutory conception of fair value, it may be said that any value determined by an expert valuer of shares, whether under an agreement or under articles, honestly and judiciously for providing just and equitable relief to all the interested parties can be appreciated as fair value, unless, of course, such value is affected by negligence, fraud, mistake or miscarriage of justice.

3. Doubts about fair value:

Despite the existence of a large number of court decisions, legal provisions and expert pronouncements on valuation and determination of fair value, there still exist some doubts about fair value and its determination. The doubts about fair value may be summed up in the following questions:

a) Is fair value a deceptive light?
b) Is fair value attainable?
c) Is it possible to lay down a formula for the calculation of fair value?

a) There are some doubts about the very nature of fair value. Some people doubt about the reality of such value. Some other people take fair value as a philosophical conception that exists only in thought not in action. Still others may think that fair value is a deceptive light—a light which every valuer desires as a goal during the
course of his valuation, but may ultimately fail to enjoy the 
sweet touch of the light and the fair value may remain a lofty 
attainable in a dreamland.
b) The deceptive nature of fair value may lead to another doubt 
about fair value and that relates to whether fair value is at 
all attainable. A goal is imaginary, if it is not attainable 
with honest and sincere efforts. It may be said that a fair value is an estimate.
In the midst of several disputes and doubts about the estimation 
of fair value, the fair value itself remains an unattainable 

Mathematical value.
c) Inspite of the doubt about the attainability of fair value of 
shares, there is no lack in efforts on the part of the valuere 
to estimate a fair value for shares. This tendency raises a 
third question about fair value and that is whether some formulae can be given 
for the computation of fair value. There is no doubt that a 
fair value for shares can not be mathematically demonstrated. 
Naturally, therefore, a fair value remains within a veil of 
uncertainty. These doubts about fair value of shares appear 
to have a very weak footing. The statutory and non-statutory 
conceptions of fair value are real and not imaginary. Fair 
value is a guiding light for the valuer to reach his destination 
smoothly. It is determined for a particular purpose and for a 
definite group of interested parties under a particular set of 
circumstances. If a value is honestly and judiciously determined
on the basis of sound and accepted principles and if it appears
to be just and equitable to the interested 
parties, it is a fair value, no matter, 
what others may think or do about it.

Fair value is not mere guess. It is not an imagination. It is 
expert opinion based on sound reasons. Opinions may differ.

Even honest estimates may vary. But that does not take away 
the essence of fair value. In Dean vs. Prince Sir Raymond 
Evershed, M.R. rightly stated:—

".......A valuation of shares in a company.......is plainly 
a matter of difficulty and one on which opinions may fairly 

differ."18

Due to several influences affecting the demand and supply 
of shares, the imperfections existing in the share market, the 
element of subjectivity prevailing in share valuation, the need 
for consideration of the facts and circumstances of the particu­
lar case etc., the valuation of shares by any two honest valuers 
may differ. But the notable point is that the differences should 
not assume such a dimension or should not be of such a nature as 
to vitiate the whole environment of valuation and to make the 
value of shares equivalent to their "throw-away price" or "fancy 
price" so that the interested parties are deprived of the real 

essence of fair value and are compelled to carry with them a 
feeling of unfair treatment.

18. Best Judgement theory of fair value:—

Fair value is what the facts and circumstances of a particu­
lar case lead a valuer to adjudicate as just and equitable for
Statement of the the parties concerned to the best of his theory, judgement. It is neither a mere guess work of a poorly informed mind nor a mathematically devised product, but is derived from an analytical and judicious exercise of discretion, independently and impartially in the light of all the relevant valuation materials and evidences presented to the valuer. It is an objective and practical manifestation of what should be the true worth of shares which can generate a sense of satisfaction and a feeling of fair treatment to all parties. The following are the essential characteristics of the best judgement theory of fair value:

1. Consideration of all facts and circumstances.

2. No application of mere guess or of any mathematically devised formula.

3. Examination of valuation materials and evidences analytically and judiciously.

4. Objective and practical decision.

5. Determination of what 'should be' the true worth of shares.

6. Best judgement of the valuer.

7. Exercise of judgement and discretion independently and impartially.

8. The conclusion from the whole exercise should be a just and equitable value.
1. **Facts and circumstances:**

Valuation of shares is made with reference to a particular case or particular purpose. It is in the light of all the circumstances of the particular case that the valuer can determine what principles to apply or what course of action to take for valuation. The concept of "facts and circumstances" was emphasized by the Supreme Court in C.W.T. vs. Mahadeo Jalan:*

The facts and circumstances of a particular case will dictate the sound basis of valuation. The case of Dean vs. Prince is an interesting illustration of how the court considered the facts and circumstances of a case before deciding on the proper basis of valuation.

2. **Guess work or mathematical formulae:**

Determination of fair value is not based on mere guess work. If at all a guess work is necessary in a particular case, it should be an intelligent guess work of a well-informed mind. Mathematical demonstration of fair value is undesirable. A brief mathematical exercise may, however, be necessary to determine a figure or to make some calculations.

3. **Examination and analysis:**

The search for fair value is a scientific approach based on examination of valuation materials and evidences analytically and judiciously. There is no short-cut process or over-simplified procedure. Through analysis and investigation of data, facts and figures, the valuer arrives at an honest and sound opinion about the value of shares.
4. **Objective and practical**: -

Fair value is practical and is not purely hypothetical. Devoid of practical outlook, fair value loses much of its fairness. Objective and practical decision on such a subjective matter as fair value is, no doubt, difficult. But the valuer faces a trouble-shooting job. Can any value calculated without taking into account the realities of the situation be called a fair value? The answer is obviously 'no'.

5. **True worth of Shares**: -

Fair value of shares is nothing more or less than the true worth of shares. It touches the heart of the transaction. Thus determination of fair value involves the task of determining what should be the genuine worth of the shares. The process involves the testing of any value (before it can be called a fair value) on the anvil of "open market price" in order to estimate what the shares ought to fetch in an open market after taking all circumstances and relevant factors into consideration.

6. **Best judgement value**: -

Exercise of discretion and judgement is essential for the determination of fair value. But the point is that the
The concept of "Best judgement" gives no indication of "sweet-will" or "the pleasure" of the valuer. On the contrary, it points to an opinion which must be the result of the valuer's objective thinking, judicious and analytical consideration of available materials, farsightedness and critical bent of mind.

7. Independence and impartiality:

Fair value is after all a logically deduced estimate made by an individual representing himself to be an expert. The courts have always recognised the opinion of experts. (State of Orissa vs. Bibhuti Bhusan Singh and another) The opinion of the valuer affects the interest of the parties concerned. It is, therefore, essential that the valuer should be impartial to all parties. He should be independent and free from all influences. The result of a valuation without independence and impartiality can never be respected and relied upon as fair.

8. Just and equitable value for all parties:

Fair value must appear to be just and equitable for all parties who must sense a fair treatment or fair deal. It must exclude unreasonable pricing of shares and irrational behaviour of the parties. Taking into account all the facts and circumstances of the case, it will have to be seen whether there is anything in the process and conduct of the valuation work which reasonably shows that the value can not be regarded as fair for all the parties interested in the valuation.
In conclusion it is necessary to state that differences in terminology regarding fair value create confusion. Since the aim of all valuers is to fix the fair value of shares, instead of using the terms, open market value, fair market value and simply market value, the simple term 'fair value' may be used for all purposes.


3. Open market concept facilitates an estimate of the best possible price which would be realised in an open and unrestricted market under the reasonable competitive conditions. (Buccleuch (Duke) Vs. I.R.C. (1967) 1 ALL E.R. 129)


5. The Companies Act, - 1956 - Sec. 108-B(3).

"Where a direction is made by the Central Government under Clause (b) of Sub-Section (2), the share referred to in such direction shall stand transferred to the Central Government or the Corporation specified therein, and the Central Government or the specified Corporation, as the case may be, shall pay in cash, to the body Corporate or bodies Corporate from which such share stands transferred, an amount equal to the market value of such share, within the time specified in Sub-Section (4)."
9. Ibid 8, p. 36.
12. Ibid 8, p. 37.
16A. Dean Vs. Prince (1954) 1 ALL E.R. 749 (C.A.)
18. Dean Vs. Prince (1954) 1 ALL E.R. 749 (C.A.)