

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 13.07.2012

CORAM:

THE HONOURABLE MRS.JUSTICE CHITRA VENKATARAMAN
and
THE HONOURABLE MR.JUSTICE K.RAVICHANDRABAABU

Tax Case (Appeal) Nos.1498 to 1502 of 2005,
123 to 126, 164 and 165 of 2006
and 1156 to 1161 of 2006

Commissioner of Wealth Tax
Chennai. .. Appellant in all these Tax Cases

versus

Shri Thirupathy Kumar Khemka
36, Wallaja Road
Chennai-600 002. .. Respondent in T.C.No.1498 of 2005

Nirmal Kumari .. Respondent in T.C.No.1499 of 2005

Narbada Devi .. Respondent in T.C.Nos.1500 and
1501 of 2005

Ritu Devi .. Respondent in T.C.No.1502 of 2005

Shri Raj Kumar Khemka .. Respondent in T.C.No.123 and 126
of 2006

Shri Raviprakash Khemka .. Respondent in T.C.Nos.124 and 125
of 2006

Mrs.Champa Devi .. Respondent in T.C.Nos.164 and
165 of 2006

Munish Kumar Khemka .. Respondent in T.C.No.1156 and
1159 of 2006

Madhusudhan Khemka .. Respondent in T.C.No.1157 and
1160 of 2006

Anitha Devi

.. Respondent in T.C.No.1158 and
1161 of 2006

PRAYER: Tax Case Appeal Nos.1498, 1499, 1500, 1501 and 1502 of 2005, 123, 124, 125, 126, 164, 165, 1156, 1157, 1158, 1159, 1160 and 1161 of 2006 are filed under Section 27A of the Wealth Tax Act, 1957 against the order dated 10.02.2005 in WTA Nos.46, 74, 68, 81, 51, 43, 45, 52, 53, 44, 54, 72, 70, 71, 85, 86 and 88/Mds/99.

For appellants in all these T.Cs.: Mr.T.R.Senthil Kumar
Standing Counsel for Income Tax

For respondent in all these T.Cs.: Mr.C.V.Rajan

JUDGMENT

(Judgment of the Court was delivered by CHITRA VENKATARAMAN,J.)

The following are the substantial questions of law raised in these Tax Case Appeals filed by the Revenue as against the order of the Tribunal.

- (i) Whether in the facts and circumstances of the case, the Tribunal was right in holding that the shares owned by the assessee could not be valued as per the rate quoted in the stock exchange as the assessee was bound by a lock in period, and could not sell those shares at that time?
- (ii) Whether on the facts and circumstances of the case the Tribunal was right in holding that the shares which are bound by the restriction of a lock in period have no value at all and cannot even be valued as per Rule 11 of Schedule III of the Wealth Tax Act?
- (iii) Whether on the facts and circumstances of the case the Tribunal was right in not applying the specific provisions of Rule 21 to Schedule III of the Wealth Tax Act, which provides that the restrictive covenant price shall be ignored for the purpose of ascertaining the market value?

2. The Tribunal considered the question at length in the common passed in the case of Munish Kumar Khemka and others, which was followed by the Tribunal in the subsequent appeals preferred in the assessment years in respect of other shareholders.

3. The question arises under the Wealth Tax Act regarding the valuation of shares which were allotted to the shareholders from promoters quota. It is seen from the narration that the shares allotted from promoters' quote suffered lock-in period and hence, could not be transferred easily as on 31.03.1992. Even though the shares were valued at Rs.10/- per share as per the original allotment, the assessee contended that the value should be taken as nil, considering the restriction on free marketability. The Assessing Officer pointed out that the shares of the company were quoted shares and as on the valuation day, each shares were valued at Rs.234/-. Pointing out to the contention of the assessee that the shares could not be

sold easily in the market during the lock-in period, the Officer pointed out that even if it be so, as per Rule 21 of the III Schedule to the Wealth Tax Act, such restrictive covenants should be ignored for the purpose of determining the market value of the shares. Thus, he arrived at the market value at Rs.210/- as on the valuation date.

4. Aggrieved by this, the assessee went on appeal before the Commissioner of Wealth Tax (Appeals). The Commissioner pointed out that as per Rule 21 dealing with the price of such asset as on the valuation date, valuation of property acquired or transferred under the terms of a deed of trust or through or under a restrictive covenant, the price at which they were acquired shall be ignored and that the price which the said property would fetch, if sold in the market on the valuation date, should be adopted. Thus the value of the property on the valuation date will prevail over the purchase price and any restrictive covenant thereon on the dealing of the property would have to be ignored. The Commissioner pointed out that when a share is quoted in the stock exchange, the quoted price would be normally taken in valuing the share (Refer Rule 9). Rule 9A provides for exception to Rule 9. However, where the stock exchange quotations are not available, in the sense that the shares are unquoted shares, Rule 11 of the Schedule would be the relevant Rule for the purpose of arriving at the value of the shares. In the given situation, the Commissioner of Wealth Tax (Appeals) pointed out that once the stock exchange quotations are not applicable to the particular lot of promoter quoted shares held by the assessee, the proper course would therefore be Rule 11 of the III Schedule. Thus, the Commissioner pointed out that the valuation taken in the Income Tax Act proceedings could not be adopted as such for the Wealth Tax Act in view of the concept of "fair market value" of the asset as on the valuation date. Thus the matter was remanded back to the Officer for working out the valuation of the shares as on 31.03.1992 as per Rule 11 of the III Schedule.

5. Aggrieved by this, the assessee and the Revenue went on appeal before the Tribunal. The Tribunal held that considering the fact that the shares could not be traded in stock exchange by reason of the lock-in period, which was not on account of any covenant in the deed of transfer or any instrument, the question of valuation as per Rule 11 in the III Schedule did not arise. In other words, the Tribunal accepted the case of the assessee that in view of the covenant restricting the transferability of the promoter quoted shares for the specified period, the question of adopting open market value did not arise. Referring to the decision reported in [1973] 88 ITR 417 (Purushottam N. Amarsay v. Commissioner of Wealth-tax), the Tribunal directed the Assessing Officer to calculate the value, following the decision laid down by the Tribunal reported in (1990) 35 ITD 402 (WTO Vs. Trustees of HEH the Nizam's Jewellery Trust), which was based on the decision of the Apex Court reported in [1973] 88 ITR 417 (Purushottam N. Amarsay v. Commissioner of Wealth-tax) and (1970) 76 ITR 471 (Ahmed G.H.Ariff Vs. CWT). In other words, the Tribunal held that the shares not having marketability, the question of considering the open market price did not arise, nor could it be valued on the basis of the price quoted in the stock exchange. Aggrieved by this, the present appeal has been preferred by the Revenue.

6. Learned Standing Counsel appearing for the Revenue pointed out that the Tribunal committed a serious error in taking the view that by reason of the restrictive covenant, the

promoters' quoted shares had no value at all. He pointed out that regardless of the restrictive covenant, the shares of the company being quoted shares, the shares ought to have been valued as per the valuation available in the stock market as on the valuation date.

7. Per contra, learned counsel appearing for the assessee placed reliance on the decision reported in [1974] 093 ITR 555 (Rathinasabapathy Chettiar (R.) Vs. Commissioner of Wealth-tax) and [1978] 112 ITR 771 (Commissioner of Gift-tax Vs. Venu Srinivasan (S.)) and pointed out that in almost similar circumstances in relation to the valuation in the shares of a private company, where the Articles of Association restricted the transferability as well as the price therein, this Court pointed out that the value ascertained on the basis of break-up method has to be further depreciated to some extent, keeping in mind the restriction contained in the Articles of Association. Learned counsel appearing for the assessee pointed out that considering the lock-in period, the assessee had the disadvantage of dealing with the shares in the open market. Hence, the question of considering the free transferability as in the case of shares available in the market did not arise. Consequently, there could be no question of adopting the value quoted in the stock exchange.

8. Heard learned counsel appearing on either side and perused the material placed on record.

9. In the decision reported in [1978] 112 ITR 771 (Commissioner of Gift-tax Vs. Venu Srinivasan (S.)), which, in turn, followed the decision reported in [1974] 93 ITR 555 (Mad) R.Rathinasabapathy Chettiar v. CWT), this Court had an occasion to consider the case of a Private Limited Company and there were restrictions incorporated in the Articles of Association regarding the transfer of shares. On the question as to whether such restriction would result in the reduction of the value of the shares, this Court pointed out that the fact that the company is a Private Limited Company and there was no freedom to deal with the shares held in the company, would not affect the question as to the possible value that the shares would fetch, had they been sold in the open market. It was pointed out that even in such cases, it should be assumed that the shares could be capable of being sold freely in the open market and there would be purchasers for the same. Hence, one has to visualise what the shares would fetch, if sold in a hypothetical market. Pointing out to the decision reported in [1970] 76 ITR 471 (Ahmed G.H. Ariff Vs. Commissioner of Wealth-tax), this Court held that under such circumstances, the Officer could take the value of the shares as shown in the balance sheet, which is based on the break-up value and the value shown in the balance sheet, which was in existence at the time of the gift, would be the market value of the shares. Considering the restrictions in the free transferability of the shares, applying the decision reported in [1974] 93 ITR 555 (Mad) R.Rathinasabapathy Chettiar Vs. CWT), this Court pointed out that one has to necessarily take into consideration such restriction having an impact on the value depreciating the value of the shares. In the circumstances, this Court remanded the matter back to the Tribunal to work out the extent of depreciation that could be considered on the value of the shares. Thus the decision reported in [1974] 93 ITR 555 (Mad) R.Rathinasabapathy Chettiar Vs. CWT) was applied in the decision reported in [1978] 112 ITR 771 (Commissioner of Gift-tax Vs. Venu Srinivasan (S.)). The principles thus laid down in the said decision are:

- (i) Whether it is possible to ascertain the market value on the date of the transaction?
- (ii) If the market value could not be ascertained, the value of the shares as shown in the balance sheet and the receipt on the time of the transaction has to be taken into account.
- (iii) After having so fixed the market value, the next question would be the adjustment towards the depreciation.

10. As far as the present case is concerned, it is no doubt true that the share was given to the assessee on promoters' quota, there being family members of the promoter; the shares were held at the value of Rs.10/- per share. It is an admitted fact that the shares of the company are quoted shares.

11. When we look at the Rules concerning valuation of shares, Part C of the III Schedule to the Wealth Tax Act, as it then stood, deals with shares or debentures of companies. Rule 9 is a specific Rule providing for the valuation of quoted shares and debentures of the company. Rule 10 deals with valuation on unquoted preference shares. Rule 11 is about valuation of unquoted equity shares in companies other than investment companies. Part H makes provision for valuation of assets which are not covered under Rules 3 to 19. Rule 20 provides for valuation of assets whose price or consideration are covered by restrictive covenants in any instrument of transfer. As already seen in the preceding paragraphs, the decision reported in [1978] 111 ITR 724 (Additional Commissioner of Income-tax Vs. Seth Devi Chand and Sons) clearly pointed out that the mere fact that the restrictions on the transferability of the shares would not affect the question as to the possible value that the shares would fetch, had they been sold in the open market. While holding that even though market value as a concept would hold good even in respect of shares suffering restriction on their transferability, this Court pointed out the need for assigning a depreciated value to such market value. This Court pointed out that since these shares, in reality, would not fetch the same amount of price as the shares enjoying easy transferability, the shares could not be treated on par more or less with the shares which can be dealt with easily or saleable readily. Thus applying the decision reported in [1974] 93 ITR 555 (Mad) R.Rathinasabapathy Chettiar Vs. CWT) to the case on hand, with a lock-in period on the shares held out of the promoters' quota, necessarily one has to arrive at the depreciated value of these shares.

12. The question as to what could be the degree of depreciation that may be granted to the shares, remains without any guidelines provided for in Part C of the III Schedule. It is an open secret that in the absence of any such guideline, the depreciation may range from 0 to 100 and it is always a question of debate. Apparently, on account of all these, we feel that the Commissioner of Wealth Tax justifiably adopted Rule 11 of Part C of the III Schedule, which is with reference to unquoted equity shares. By adopting the principle as given under Rule 11, we are neither treating the shares as unquoted shares, nor are we ignoring the fact that the company's shares are quoted shares. All that one does by applying the principle in Rule 11 is to arrive at the valuation of a shares which are quoted shares, but suffering restriction on free transferability. We feel, that would, in fairness, answer the question as to what could be the depreciated value of a promoters' quota shares. Though the assessee is not in a position to show what could be the depreciated value of the restriction on the transfer, even invoking Rule

21, as had been done by the Revenue, we find that Rule 11 could only be a plausible method to arrive at the depreciated value of a quoted share, which suffers a lock-in period, by reason of it being allotted as a promoters' quota.

13. In the circumstances, we allow the Tax Case Appeals filed by the Revenue only to the extent of holding that the shares held in promoters' quota for a lock-in period could be allowed by adopting the methodology under Rule 11. No costs.

Index: Yes / No

(C.V.,J.) (K.R.C.B.,J.)

Internet: Yes / No

13.07.2012

ksv

To

1. The Income Tax Appellate Tribunal, Chennai Bench 'B'.
2. The Commissioner of Wealth Tax (Appeals)-II, Chennai-34.
3. The Assistant Commissioner of Income Tax, Central Circle I(1), Madras-34.

CHITRA VENKATARAMAN,J.

and

K.RAVICHANDRABAABU,J.

ksv

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