

FORTY-EIGHTH REPORT
PUBLIC ACCOUNTS COMMITTEE
(1985-86)

(EIGHTH LOK SABHA)

**INCORRECT VALUATION OF UNQUOTED EQUITY
SHARES AND EFFECT OF CHANGE OF PREVIOUS
YEAR**

MINISTRY OF FINANCE
DEPARTMENT OF REVENUE

[Action Taken on 203rd Report (Seventh Lok Sabha)]

Presented in Lok Sabha on 30-4-1986
Laid in Rajya Sabha on 30-4-1986

LOK SABHA SECRETARIAT
NEW DELHI

April, 1986/Vassakha, 1908 (Bik.)

Price . Rs. 5 49

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PERSONNEL OF THE COMMITTEE ON PUBLIC ACCOUNTS
(1985-86)

CHAIRMAN

Shri E. Ayyapu Reddy

MEMBERS

Lok Sabha

2. Shri J. Chokka Rao
3. Shri Amal Datta
4. Shri Ranjit Singh Gaekwad
5. Shrimati Prabhawati Gupta
6. Shri Harpal Singh
7. Shri Vilas Muttemwar
8. Shri G. Devaraya Naik
9. Shri Rameshwar Neekhra
10. Shri Rajmangal Pande
11. Shri H. M. Patel
12. Shrimati Jayanti Patnaik
13. Shri S. Singaravadivel
14. Shri Simon Tigga
15. Shri Girdhari Lal Vyas

Rajya Sabha

16. Shrimati Amarjit Kaur
17. Shri Nirmal Chatterjee
18. Miss Jayalalitha
19. Shri Ghulam Rasool Kar
20. Shri Chaturanan Mishra
21. Shri K. L. N. Prasad
22. Shri Ramanand Yadav

SECRETARIAT

1. Shri N. N. Mehra—*Joint Secretary*
2. Shri K. H. Chhaya—*Chief Financial Committee Officer*
3. Shri O. P. Babal—*Senior Financial Committee Officer*

INTRODUCTION

I, the Chairman of the Public Accounts Committee, as authorised by the Committee, do present on their behalf this 48th Report on action taken by Government on the recommendations/observations of the Public Accounts Committee contained in their 203rd Report (7th Lok Sabha) relating to incorrect valuation of unquoted equity shares and effect of change of previous year.

2. In this action taken Report, the Committee have noted that the Ministry of Finance have not made any earnest attempt to plug the loopholes pointed out by them from time to time in their earlier Reports in the manner of valuation of unquoted equity shares. The Ministry did not even keep in view the recommendations of the Committee while framing draft Wealth Tax (Amendment) Rules, 1986 issued on 31 March, 1986. The Committee have desired the Ministry to undertake a study of the cases involving incorrect valuation of shares of private companies with a view to identifying the ambiguities and loopholes in the rules which were largely responsible for unquoted equity shares being undervalued. On the basis of the study so made suitable provisions or amendments should be incorporated in the draft Wealth Tax Rules. In order to secure uniformity in the area of valuation of unquoted equity shares of closely held companies, the Committee have suggested that the Wealth Tax Rules be amended so as to provide that the shares of private companies be valued annually and information regarding the value arrived at by the assessing officer circulated to all the assessing officers having jurisdiction over the assessment of share-holders of the companies. In case the assessee claims that his shares have been over-valued, the Government should have the right to acquire the shares at the value claimed by the assessee. This, the Committee consider, will act as a deterrent to the unscrupulous assessees in the matter of valuation of shares.

3. The Committee considered and adopted the Report at their sitting held on 25 April, 1986. The Minutes of the sitting form Part II of the Report.

4. For facility of reference and convenience, the recommendations and observations of the Committee have been printed in thick type in the body of the Report and have also been reproduced in Appendix to the Report.

5. The Committee place on record their appreciation of the assistance rendered to them in this matter by the Office of the Comptroller and Auditor General of India.

NEW DELHI;
29 April, 1966

Vaisakha 9, 1908 (Saka)

E. AYYAPU REDDY,
Chairman,
Public Accounts Committee.

REPORT

CHAPTER I

This Report of the Committee deals with the action taken by Government on the Committee's recommendations/observations contained in their Two Hundred and Third Report (Seventh Lok Sabha) on Paragraphs 4.07 (iv) and 4.15 of the Report of the Comptroller and Auditor General of India for the year 1980-81, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes relating to Incorrect valuation of Unquoted Equity Shares and effect of change of previous year.

1.2 The Committee's 203rd Report was presented to Lok Sabha on 27 April, 1984. It contained 6 recommendations and observations.

1.3 Action Taken Notes have been received in respect of all the recommendations/observations. These have been broadly categorised as follows:—

- (i) Recommendations and observations which have been accepted by Government:

Sl. No. 2.

- (ii) Recommendations and observations which the Committee do not desire to pursue in view of the replies of Government:

Sl. Nos. 5 and 6.

- (iii) Recommendations and observations replies to which have not been accepted by the Committee and which require reiteration:

Sl. Nos. 1, 3 and 4.

- (iv) Recommendation and observation in respect of which Government have furnished interim reply:

Nil.

1.4 The Committee will now deal with the action taken by Government on some of the recommendations.

Mode of valuation of unquoted equity shares

1.5 In paragraphs 1.22, 1.24 and 1.25 of their 203rd Report (Seventh Lok Sabha), the Public Accounts Committee had recommended as follows:—

“The Committee observe that the shares of M/s. K.P.P. Ltd. were valued at Rs. 2902/- for Wealth-tax on 31-3-1973 and at Rs. 7400/- for income tax on 31-12-1973. The main reason contributing to high rise in the share value was the accrual of goodwill of Rs. 10 crores as on 30-6-1973 on transfer of manufacturing units to subsidiaries companies. This amount is 300 per cent more than the entire capital of this company of Rs. 2.88 crores resulting in rise in the computation of share value. It is apparent that heavy under-valuations have been occurring in the valuation of unquoted equity shares of companies under rule 1 D of Wealth-Tax Rules which does not take into account the hidden reserves of companies. The loopholes in Rule 1 D of the Wealth-Tax Rules were pointed out to Government as early as in 1977 *vide* paragraph 4.22 of the 226th Report of the Public Accounts Committee (5th Lok Sabha) for review and rectification. In January 1982, the Committee were informed that the Board had framed draft rules in substitution of Rule 1 D and invited public comments thereon. The Committee observe that the draft rules as notified for general information and public comments also contain provisions for valuation of unquoted equity shares of investment companies. The Committee trust that the new Rules will take due care of not only the hidden reserves of Private companies as pointed out in the instant case but also of other loopholes contributing to under-valuation of unquoted equity shares of private companies pointed out by the Committee from time to time. The Committee also trust that the new Rules will be finalised and promulgated without further delay. (Para 1.22).

It is not clear to the Committee as to what systems approach is being adopted by the Central Board of Direct Taxes with a view to make the task of the ITO|WTO in regard to valuation of assets and liabilities in general, and valuation of unquoted shares of companies, in particular, administratively manageable. Such shares may be held by any number of income tax or wealth tax assesseees and as already pointed out there may be no uniformity in their

valuation. The Act and the Rules made there under visualise the assessee engaging the services of registered valuers. But apparently valuations under that scheme have not proved reliable in that the valuations made by the registered valuers is not always admitted by ITO|WTO as the true valuation. The fact that the valuations by departmental officers often differ is adequate evidence of the failure of the system of valuation by registered valuers who are engaged by the assesseees and who are also paid by the assesseees. Even if 4 assesseees on an average hold shares of a private company (and there are about 50 thousand private companies in the country presently) 2 lakh valuations will need to be done every year. It will involve valuation of all the assets (including goodwill) and liabilities of the company. A private company may hold shares of another such company and that may well make the task of valuation of the shares in former company more time consuming and difficult. The Committee also understand that under the existing law, the valuation made by the valuation officers of the department is binding only in respect of the case in which reference has been so made. If an assessee were to object to the adoption in his case of the value as determined by the valuation officer in another case, the Department would be bound to make a fresh reference to the Valuation Officer. Furthermore, under the existing arrangements, different assessing officers refer the question of valuation of unquoted equity shares of the same company, as on a particular date, to different valuation officers. In such a case the valuation would not be uniform and in respect of the same share; different values are likely to be adopted in different assessments. Further, the value of unquoted shares may very widely from year to year even in the hands of the same assessee, depending on how the private company is faring.

In the opinion of the Committee, the magnitude of the problem requires a bold approach to the question of valuation of unquoted shares. The valuation should be based on the yield method. But since the yield can be deliberately suppressed and reserves can be accumulated by a private company without declaring dividends, the law and the rules will have to provide for correct valuation in such a case also. The Committee would recommend that the

Companies Act should be immediately amended in order to ensure that valuation of unquoted shares of the company is given as a footnote in the balance sheet of the company and it is certified by the Auditor. In the balance sheet such valuation should be given after computing it by reference to amending provisions to be made in the Companies Act which provisions should indicate the manner of computation and the provisions should have relevance for all valuations under the fiscal Acts in the country. (Para 1.24).

The Committee have already recommended, in another context, the setting up of an autonomous valuation authority, in paragraph 3.79 of the 101st Report (7th Lok Sabha). The Committee would recommend the immediate setting up of such a Centralised valuation Authority under the CRDT which, in the opinion of the Committee, should set the lead for such a scientific administration of tax laws in the area of valuation. This is necessary to complement a decentralised system of certification of valuation of unquoted shares of companies by the Chartered Accountants as recommended in the preceding paragraph. However, in exceptional cases, it should be open to an ITO|WTO but only for reasons to be recorded in writing to challenge valuation of unquoted shares certified by a Chartered Accountant as being unreasonable or unrealistic in his view. Only thereafter should such a valuation be referred by the Commissioner to the Centralised Valuation Authority proposed herein provided he agrees with the ITD|WTO. This is necessary in view of the number of the valuations involved every year. The Committee, therefore, suggest that necessary amendment to the Companies Act should be initiated forthwith and the centralised valuation authority set up thereafter. (Para 1.25)

1.6 In their Action Taken Note the Ministry of Finance (Department of Revenue) have stated as under:—

“The recommendation made by the Hon’ble Committee relating to amendment of the Companies Act, 1956 was referred to the Department of Company Affairs for the comments. A copy of the note received from Department of Company Affairs is enclosed. The Department of Company Affairs

found the recommendation to be unacceptable and expressed the view that the problems regarding valuation of shares had to be solved through suitable amendment of the direct tax laws rather than through amendment of the Companies Act, 1956.

- (2) The recommendation of the Committee was examined in the light of the comments offered by the Department of Company Affairs and in the light of the draft Wealth-tax (Amendment) Rules, 1981. It was felt that with the raising of the exemption limit for the purposes of wealth-tax to Rs. 2.5 lakhs and the reduction in the maximum marginal rate of wealth-tax to 2 per cent, the motivation for avoidance of wealth-tax through valuation of shares would not be as strong now as it was when the draft wealth-tax (Amendment) Rules, 1981 were published. Further, the problem relating to avoidance of wealth-tax through transfer of assets by individuals to closely held companies has since been attempted to be tackled by a limited levy of wealth-tax on certain assets of the closely-held companies under Section 40 of the Finance Act, 1983. It was, therefore, decided with the approval of the Finance Minister that the existing provisions of wealth-tax rules in regard to the valuation of unquoted shares may be left unchanged and that the recommendation made by the Public Accounts Committee in this regard may not be accepted."

1.7 In their earlier Report the Committee had pointed out that heavy under-valuation had been occurring in the valuation of unquoted equity shares of private companies under Rule 1 D of the Wealth Tax Rules which did not take into account the hidden reserves of the private companies but also other loopholes contributing to the under-valuation of unquoted equity shares of private companies pointed out by the Committee from time to time.

1.8 The Ministry of Finance (Department of Revenue) have, in their action taken note, stated, inter alia, that "with the raising of the exemption limit for the purposes of wealth tax to Rs. 2.5 lakhs and the reduction in the maximum marginal rate of wealth tax to 2 per cent, the motivation for avoidance of wealth tax through valuation of shares would not be as strong now as it was when the draft Wealth Tax (Amendment) Rules, 1981, were published. Further, the problem relating to avoidance of wealth tax through transfer of assets by individuals to closely held companies has since been

attempted to be tackled by a limited levy of wealth tax on certain assets of the closely held companies under Section 40 of the Finance Act, 1983". The Ministry have, therefore, decided with the approval of the Finance Minister not to accept the recommendation of the Committee.

1.9 Valuation of shares and avoidance of wealth tax are two different issues and the raising of exemption limit for the purposes of wealth tax by no means, is an answer to the real problem of undervaluation of unquoted equity shares. The basic principle under the Wealth Tax Act for the valuation of shares is the market value. The Committee had been pointing out from time to time since the year 1977 the loopholes in the manner of valuation of unquoted equity shares. The Committee learn that the CBDT have proposed amendments to the Wealth Tax Rules, 1957 through the Draft Wealth Tax (Amendment) Rules, 1986 issued on 31 March, 1986. The Committee are surprised to note that their recommendations have not been considered while framing the Draft Rules. It seems that the Ministry have not relied on their experience and no earnest attempt has been made to plug the loopholes. The Committee hope that the Ministry would reconsider their stand in the matter. The Committee would like the Ministry to undertake a study of the cases involving incorrect valuation of shares of private companies with a view to identifying the ambiguities and loopholes in the rules which were largely responsible for unquoted equity shares being undervalued. While doing so, they should keep in view the observations of the Committee and the comments of the Audit so far on the subject. On the basis of study so made, suitable provisions or amendments should be incorporated in the draft Wealth Tax Rules under consideration of the Ministry.

1.10 In order to secure uniformity in the area of valuation of unquoted equity shares of closely-held companies, the Committee had also recommended amendment of the Companies Act, requiring the companies to indicate the value of unquoted shares, as certified by the auditors, in a footnote in their balance-sheets. The Committee have been informed that the Department of Company Affairs is not agreeable to the amendment of the Companies Act for the reason that the problem regarding valuation of unquoted equity shares should be resolved through the amendment of the Direct Tax Laws and not through the amendment of the Companies Act. The Committee feel that if it has not been found advisable to amend the Companies Act, the alternate course with the Ministry of Finance would be to have recourse to the amendment of the provisions of

the Wealth Tax Rules. The Committee suggest that the Wealth Tax Rules be so amended as to provide that the shares of private companies be valued every year by the assessing officer assessing the companies and information regarding the value arrived at circulated to all the assessing officers having jurisdiction over the assessment of the shareholders of the companies. This will undoubtedly go a long way in eliminating the multiplicity of assessments at the hands of different assessing officers, of the value of shares held by various shareholders in the same company.

1.11 The Committee also suggest that in case the assessee claims that his shares have been overvalued by the assessing officer, the Government should have a right to acquire the share at the value claimed by the assessee. This will no doubt act as a deterrent to the unscrupulous assesseees in the matter of valuation of shares.

CHAPTER II
RECOMMENDATIONS/OBSERVATIONS WHICH HAVE BEEN
ACCEPTED BY GOVERNMENT

Recommendation

The Committee note that the Central Board of Direct Taxes had issued instructions on 20-5-1978 requiring the Commissioners of Income-tax to circulate copies of fair and correct valuation reports relating to unquoted equity shares held in a Company by a shareholder assessed in their charges to the officers in their charge as well as to the other Commissioners for being followed wherever necessary in respect of other shareholders of the same company. The Committee, however, regret to observe that the concerned Commissioners of Income-tax had not circulated orders of valuation of shares of any of the companies in their charges. The Committee need hardly point out that the instructions have value if they are complied with). They desire that effective steps should be taken by the Board to ensure that the instructions issued by it are complied with by the lower formations in letter and spirit.

[S. No. 2 (Para 1.23) of 203rd Report of Public Accounts
Committee (1983-84) (Seventh Lok Sabha)]

Action Taken

Ordinarily, it is taken to be the duty of all the Supervisory Officials in the Income-tax Department as well as of the Central Board of Direct Taxes to see that the Board's instructions are followed by the field offices. It is one of the functions of the IACs to ensure this in course of their inspection of the work of the Income-tax Officers. Similarly, the Commissioners of Income-tax and Directors of Inspection, as well as the Members of the Central Board of Direct Taxes during the course of their tours or the Income-tax Officers see whether the instructions issued by the Central Board of Direct Taxes are being implemented. The internal Audit Parties also carry out this function while checking the assessment orders. There is an Inspection Division functioning directly under the Central Board of Direct Taxes which also look into this aspect. To supplement the work of this division, System Review teams have also been set up at important places like Bombay, Madras, Calcutta, Ahmedabad and Delhi to ensure, *inter alia*, that Board's instructions on important matters are being followed in the field.

[Approved by the Additional Secretary to the Govt. of India].

[M/o Finance (Deptt. of Revenue) O.M. No. F. No. 241/4/84-
A & PC-I dated 25-10-1984]

CHAPTER III

RECOMMENDATIONS/OBSERVATIONS WHICH THE COMMITTEE DO NOT DESIRE TO PURSUE IN THE LIGHT OF THE REPLIES RECEIVED FROM GOVERNMENT

Recommendation

Audit has pointed out an instance wherein a change in the previous year permitted by the Income-tax Officer to an assessee trust had resulted in loss of revenue of about Rs. 4,88,000 in that the wealth valued at Rs. 72,26,500 had escaped assessment to wealth-tax in respect of the assessment year 1974-75. Such instances have come to notice in the past also wherein consent given by the Income-tax Officer for the change of the accounting year had resulted in loss of revenue. Under Section 3(4) of the Income-tax Act, 1961 an assessee can change his previous year in respect of a business or profession with the consent of the Income-tax Officer, upon such conditions as the I.T.O. may think fit to impose. The Central Board of Direct Taxes have issued instructions for the guidance of the field officers from time to time. It has been laid down therein that Income-tax Officers should scrutinise each application for permission to change the accounting period and satisfy themselves that the assessee is not attempting to make use of the device of changing his accounting period in a manner that would cause serious detriment to revenue. The fact that such cases continue to occur despite repeated instructions issued by the Board indicates that the existing instructions do not offer much help to the Income-tax Officers. The Committee also observe that the instructions as worded at present are vague in that they do not clearly spell out the Circumstances in which a change in accounting period may be refused by the Income-tax Officer. The Committee would like the Ministry to examine the feasibility of amending the existing instructions so as to clearly spell out their intention as also the precise steps which an Income-tax Officer may have to take to safeguard the interest of revenue in such cases.

[S. No. (para 2.14) of the 203rd Report of PAC (1983-84)
(7th Lok Sabha)]

Action Taken

In the light of the recommendation made by the Hon'ble Public Accounts Committee at para 2.14 of the 203rd report (1983-84), the existing instructions regarding change of previous years have been modified. Necessary instructions have been issued to all the Cs. I.T. vide Instruction No. 1700 dated 27-2-86 (copy enclosed).

[M/o Finance (Deptt. of Revenue) O.M. No. F. No. 241/4/84-
A & PAC-I 14-3-1986]

COPY

INSTRUCTION No. 1700

F. No. 326/17/84-WT

GOVERNMENT OF INDIA

CENTRAL BOARD OF DIRECT TAXES

New Delhi, the 27th Feb., 1986

To

All Commissioners of Income-tax

Sir,

SUB:—Change in previous year—Effect on Wealth-tax Assessments—regarding—

Attention is invited to Board's Instruction No. 1002 dated 26th August, 1976 and Instruction No. 1341 dated 21st July, 1980 explaining the circumstances under which a change in the previous year was allowed by an I.T.O. under Section 3(4) of the Income-tax Act, 1962. It would lead to loss to revenue.

2. Cases of escapement of wealth-tax assessment on account of change of previous year allowed by ITO for income-tax purposes still continue to be pointed out by Audit. In para 2.14 of their 203rd Report (1983-84), the Hon'ble P.A.C. have expressed unhappiness over the situation in the following terms:—

PARA 2.14

Audit has pointed out an instance wherein a change in the previous year permitted by the Income-tax Officer to an assessee trust had resulted in loss of revenue of about Rs. 4,88,000 in that the wealth valued at Rs. 72,26,500 had escaped assessment to wealth-tax in respect of the assessment year 1974-75. Such instances have come to notice in the past also wherein consent given by the Income-tax

Officer for the change of the accounting year had resulted in loss of revenue. Under Section 3(4) of the Income-tax Act, 1961 an assessee can change his previous year in respect of a business or profession with the consent of the Income-tax Officer, upon such conditions as the I.T.O. may think fit to impose. The Central Board of Direct Taxes have issued instructions for the guidance of the field officers from time to time. It has been laid down therein that Income-tax Officers should scrutinise each application for premission to change the accounting period and satisfy themselves that the assessee is not attempting to make use of the device of changing his accounting period in a manner that would cause serious detriment to revenue. The fact that such cases continue to occur despite repeated instructions issued by the Board indicate that the existing instructions do not offer much help to the Income-tax Officers. The Committee also observed that the instructions as worded at present are vague in that they do not clearly spell out the circumstances in which a change in accounting period may be refused by the Income-tax Officer. The Committee would like the Ministry to examine the feasibility of amending the existing instructions so as to clearly spell out their intention as also the precise steps which an Income-tax Officer may have to take to safeguard the interests of revenue in such cases.

3.1 In view of the observations made by the PAC the Board desires that ITO's should take proper care to safeguard the interests of revenue under the Wealth Tax Act also while allowing a change of previous year. In no case the wealth tax assessment should be allowed to escape. Since the Income-tax Officer may impose any conditions while allowing a change of previous year, he must consider the terms put forward by the assessee carefully and if he finds that the terms are insufficient to safeguard the interest of revenue, he has a good ground for refusing the change. Following guidelines are given with a view to protect the interests of revenue under the Wealth Tax Act while allowing a change of previous year:—

3.2 The Wealth tax is levied on net wealth of a person on a particular date known as the valuation date. The valuation date as defined in Section 2(q) of the Wealth Tax Act is linked with the previous year as defined in Section 3 of the Income Tax Act, 1961. The previous year is either the financial year preceding the assessment year is either accounting year ending on any date falling within the financial year preceding the assessment year. W.T.O. may allow change of previous year only in certain type of situations.

3.3 In cases where the previous year ends on a date other than 31st March, the W.T.O. can allow a change of previous year to a date

beyond a period of 12 months but before 31st March of the subsequent year. However, in cases where the previous year is followed by the assessee as the financial year, the Income-tax Officer cannot extend the previous year beyond 12 months as it would lead to omission of one wealth tax assessment. For example, in one case the assessee has having the financial year as the previous year for the purpose of Income-tax. It changed its previous year to the year ending June 30th, for the assessment year 1957-58. The valuation date was thus June 30th, 1957 for which the assessment year was 1958-59 and not 1957-58 and no assessment could thus be made under the Wealth Tax Act, 1957 on the assessee for the assessment year 1957-58. In such a case the ITO would have made the income tax assessment for 1957-58 in respect of the previous year of three months i.e. 1-4-56 to 30th June, 1956. The corresponding valuation date would have been 30th June, 1956 and there could be no escapement of wealth tax for 1957-58.

3.4 The Income-tax Officer has to bear in mind certain other facts also while allowing a change of previous year. In view of the Supreme Court's decision as reported in 69 ITR 864 the liability to pay wealth tax becomes crystallised on the valuation date and not on the first date of the assessment year, though the tax is levied and becomes payable in the relevant assessment year. The ITO has also to compare the rates of tax for the original previous year and the changed previous year and the concessions in the form of deductions and exemptions relevant for those two years, while considering the interests of revenue. If any such case comes to the notice of the Commissioner of Income-tax, where there is a loss of revenue or an escapement of assessment, he may invoke the provisions of Section 263 of the Income-tax Act or Sec.25(2) of the Wealth-tax Act.

3.5 It may also be pointed out that there may be cases where no formal application is made requesting for a change in previous year but a change is noticed in the return of income-or wealth filed. The ITO must treat such a return as an application for change of previous year and pass order explicitly. In cases, the return is accepted without any objection, it will lead to implied consent for the change of previous year which may result in loss of revenue.

4. The guidelines as given above may be brought to the notice of officers working in your charge.

5. Hindi version will follow.

(A. K. FOTEDAR),
 UNDER SECRETARY
 CENTRAL BOARD-OF DIRECT TAXES

Copy to:—

1. All Directors of Inspection.
2. The Director General (Training), National Academy of Direct Taxes, Nagpur.
3. Ministry of Law (Deptt. of Legal Affairs).
4. Director of O&M Services, Aiwan-e-Ghalib, Mata Sundri Lane, New Delhi.
5. The C&AG of India, New Delhi—25 spare copies.
6. Statistician (Income-tax) 2 copies.
7. Statistician (Income-tax), 2 copies.
8. Chief Engineer (Valuation), 11th Floor, Rohit House, No. 3, New Delhi.
9. The Chief Engineer, Valuation Cell "I.T. Deptt. Chordia Bhawan 3rd Floor, No. 623 Mount Road Madras.
10. The registrar of Income-tax, Appellate Tribunal.
11. All officers and Sections in the Technical Wing of C.B.D.T.
12. Inspection Division (CBDT), Mayur Bhawan, New Delhi.
13. Director General (S.I.), New Delhi.

(A. K. FOTEDAR)

UNDER SECRETARY
CENTRAL BOARD OF DIRECT TAXES

Recommendation

The Committee observe from a statement furnished by the Ministry that the net wealth of the assessee trust had suddenly dropped from Rs. 72,26,481 in the assessment year 1973-74 to Rs. 44,69,425 in the assessment year 1975-76 and to Rs. 1,93,230 in the assessment year 1976-77. The Committee would like the Department to ascertain the reasons for the sudden fall in the assessed net wealth of assessee trust for appropriate action. The Committee would like to have a further report in the matter.

[S. No. 6 (para No. 2.15) of the 203rd Report of PAC (1983-84)
(7th Lok Sabha)]

Action Taken

For the assessment years 1973-74 and 1975-76, the Trust was assessed in respect of its entire wealth in accordance with the provisions of Section 21A of the Wealth Tax Act as the Trust did not fulfil the requirements imposed by Section 13(3) of the Income-tax Act. A comparative break-up of the assets for the aforesaid two assessment years is furnished as Annexure 'A'. The reduction in the net wealth as on the valuation date relating to the assessment year 1975-76 is mainly on account of the following:—

- (i) During the previous year relevant to the assessment year 1975-76, the Trust made donation amounting to Rs. 27.39 lakhs. The gross income for the year was Rs. 7,19,352 and therefore the excess of expenditure over income amounting to Rs. 22,68,530 went to deplete the assets of the Trust. For this purpose the Trust disposed of 2270 (out of 2595) shares of Karamchand Thapar and Bros. Ltd. for Rs. 26.44 lakhs.
- (ii) The valuation in respect of quoted shares came down to Rs. 6.19 lakhs as on 30-6-1974 from 7.84 lakhs as on 31-3-1973.
- (iii) There were certain fluctuations in the value of the remaining unquoted shares as well as certain changes in respect of debts and liabilities as reflected in the break-up of net wealth for both the assessment years in Annexure-'A'.

For the assessment year 1976-77 the trust was assessed under Section 21A read with second proviso thereof only in respect of 325 shares of Karamchand Thaper and Bros. Ltd. worth Rs. 2,119/-. After deduction under Section 5(1A) and Wealth Tax liability, the net wealth was determined at Rs. 193,223/-. As the investment by the Trust in Karamchand Thapar & Bros. Ltd. which came within the mischief of Section 13(3) of the Income-tax Act, was during the previous year relevant to the assessment year 1976-77, within 5 per cent of the Capital of the said company, exemption from Wealth-tax in respect of other assets of the Trust had to be allowed under Section 5(1) (i) of the Wealth Tax Act and only the value of shares of Karamchand Thapar & Bros. Ltd. was assessed to Wealth-tax Act. Hence the net wealth for the assessment year was determined at Rs. 193,223/- or Rs. 193,230/- in round figures.

(Approved by the Additional Secretary to the Govt. of India)

[M/o Finance (Deptt. of Revenue) O.M. No. F. No. 241/4/A &
PAC-1 dated 25-10-1984]

ANNEXURE-'A'

Break-up of net wealth in the case of Mohini Thapar Charitable Trust.

(In Rs.)

Particulars of Assets/Liabilities	Value as on 31-3-1973	Value as on 30-6-1974.
1. Shares-(as reduced by Rs. 1,50,000 being exempt)	82,38,713	56,84,471
2. Loans and advances	15,34,119	12,72,735
3. Income-tax deducted at source	2,88,311	3,46,271
4. Hundewal Firm Expenses	2,083	..
5. Stock in hand of firm products	446
6. Cash & Bank balances	25,235	21,799
7. Land	2,24,213	2,24,213
	<hr/> 1,03,32,674	<hr/> 75,69,935
Less:—Exemption for Agricultural land	1,50,000	..
	<hr/> 1,11,82,674	<hr/> 75,69,935
Less: Debts and Liabilities:	Rs.	Rs.
(i) Loan	17,25,000	17,25,000
(ii) Other Liabilities	2,26,326	4,52,149
(iii) Income-tax Liabilities	5,16,749	5,45,603
(iv) Wealth-tax Liabilities	4,88,118	2,77,760
	<hr/> 29,56,193	<hr/> 31,00,512
	<hr/> 72,26,481	<hr/> 44,69,423

CHAPTER IV

RECOMMENDATIONS/OBSERVATIONS THE REPLIES TO WHICH HAVE NOT BEEN ACCEPTED BY THE COMMITTEE AND WHICH REQUIRE RETERATION

Recommendation

The Committee observed that the shares of M/s K. P. P. Ltd. were valued at Rs. 2902|- for Wealth-tax on 31-3-1973 and at Rs. 7400|- for income tax on 31-12-1973. The main reason contributing to high rise in the share value was the accrual of goodwill of Rs. 10 crores as on 30-6-1973 on transfer of manufacturing units to subsidiaries companies. This amount is 300 per cent more than the entire capital of this company of Rs. 2.88 crores resulting in rise in the computation of share value. It is apparent that heavy under-valuations have been occurring in the valuation of unquoted equity shares of companies under rule 1 D of Wealth-tax Rules which does not take into account the hidden reserves of companies. The loopholes in Rule 1D of the Wealth Tax Rules were pointed out to Government as early as in 1977 vide paragraph 4.22 of the 226th Report of the Public Accounts Committee (5th Lok Sabha) for review and rectification. In January 1982, the Committee were informed that the Board had framed draft rules in substitution of Rule 1D and invited Public Comments thereon. The Committee observe that the draft rules as notified for general information and public comments also contain provisions for valuation of unquoted equity shares of investment companies. The Committee trust that the new Rules will take due care of not only the hidden reserves of Private companies as pointed out in the instant case but also of other loopholes contributing to under-valuation of unquoted equity shares of private companies pointed out by the Committee from time to time. The Committee also trust that the new Rules will be finalised and promulgated without further delay.

It is not clear to the Committee as to what systems approach is being adopted by the Central Board of Direct Taxes with a view to make the task of the ITO/WTO in regard to valuation of assets and liabilities in general and valuation of unquoted shares of companies, in particular, administratively manageable. Such shares may be held by any number of income tax or wealth tax assesses and as already pointed out there may be no uniformity in their valuation. The Act and the Rules made thereunder visualise

the assessee engaging the services of registered valuers. But apparently valuations under that scheme have not proved reliable in that the valuation made by the registered valuers is not always admitted by ITO/WTO as the true valuation. The fact that the valuations by departmental officers often differ is adequate evidence of the failure of the system of valuation by registered valuers who are engaged by the assesseees and who are also paid by the assesseees. Even if 4 assesseees on an average hold shares of a private company (and there are about 50 thousand private companies in the country presently) 2 lakh valuations will need to be done every year. It will involve valuation of all the assets (including goodwill) and liabilities of the company. A private company may hold shares of another such company and that may well make the task of valuation of the shares in former company more time consuming and difficult. The Committee also understand that under the existing law, the valuation made by the valuation officers of the department is binding only in respect of the case in which reference has been so made. If an assessee were to object to the adoption in his case of the value as determined by the valuation officer in another case, the Department would be beyond to make a fresh reference to the valuation Officer. Furthermore under the existing arrangements, different assessing officers refer the question of valuation of unquoted equity shares of the same company, as on a particular date, to different valuation officers. In such a case the valuation would not be uniform and in respect of the same share; different values are likely to be adopted in different assessments. Further, the value of unquoted shares may vary widely from year to year even in the hands of the same assessee, depending on how the private company is faring.

In the opinion of the Committee, the magnitude of the problem requires a bold approach to the question of valuation of unquoted shares. The valuation should be based on the yield method. But since the yield can be deliberately suppressed and reserves can be accumulated by a private company without declaring dividends, the law and the rules will have to provide for correct valuation in such a case also. The Committee would recommend that the Companies Act should be immediately amended in order to ensure that valuation of unquoted shares of the company is given as a footnote in the balance sheet of the company and it is certified by the Auditor. In the balance sheet such valuation should be given after computing it by reference to amending provisions to be made in the Companies Act which provisions should indicate the manner of computation and the provisions should have relevance for all valuations under the fiscal Acts in the Country.

The Committee have already recommended, in another context, the setting up of an autonomous valuation authority, in paragraph 3.79 of the 101st Report (7th Lok Sabha). The Committee would recommend the immediate setting up of such a Centralised Valuation Authority under the CBDT which, in the opinion of the Committee, should set the lead for such a scientific administration of tax laws in the area of valuation. This is necessary to complement a decentralised system of certification of valuation of unquoted shares of companies by the Chartered Accountants as recommended in the preceding paragraph. However, in exceptional cases, it should be open to an ITO/WTO but only for reasons to be recorded in writing to challenge valuation of unquoted shares certified by a Chartered Accountant as being unreasonable or unrealistic in his view. Only thereafter should such a valuation be referred by the Commissioner to the Centralised Valuation Authority proposed herein provided he agrees with the ITO/WTO. This is necessary in view of the number of the valuations involved every year. The Committee, therefore, suggest that necessary amendment to the Companies Act should be initiated forthwith and the Centralised Valuation Authority set up thereafter.

[S. Nos. 13 and 4 (Paras 1.22, 1.24 and 1.25) of the 203rd Report of Public Accounts Committee, 1983-84 (7th Lok Sabha)]

Action Taken by the Ministry

The recommendation made by the Hon'ble Committee relating to amendment of the Companies Act, 1956 was referred to the Department of Company Affairs for their comments. A Copy of the note received from Department of Company Affairs is enclosed. The Department of Company Affairs found the recommendation to be unacceptable and expressed the view that the problems regarding valuation of shares had to be solved through suitable amendment of the direct tax laws rather than through amendment of the Companies Act, 1956.

2. The recommendation of the Committee was examined in the light of the comments offered by the Deptt. of Company Affairs and in the light of the draft Wealth-tax (Amendment) Rules, 1981. It was felt that with the raising of the exemption limit for the purposes of wealth-tax to Rs. 2.5 lakhs and the reduction in the maximum marginal rate of Wealth-tax to 2 per cent, the motivation for avoidance of wealth-tax through valuation of shares would not be as strong now as it was when the draft wealth-tax (Amendment)

Rules, 1981 were published. Further, the problem relating to avoidance of wealth-tax through transfer of assets by individuals to closely held companies has since been attempted to be tackled by a limited levy of wealth-tax on certain assets of the closely-held companies under Section 40 of the Finance Act, 1983. It was, therefore, decided with the approval of the Finance Minister that the existing provisions of wealth-tax rules in regard to the valuation of unquoted shares may be left unchanged and that the recommendation made by the Public Accounts Committee in this regard may not be accepted.

(Approved by the Joint Secretary to the Government of India)
[M/o Finance (Deptt. of Revenue) O.M. No. F. No. 241/4/84-
A & PAC-I dated 18-9-1985]

Comments of the Department of Company Affairs

Subject:—203rd Report of the Public Accounts Committee (1983-84)-
(7th Lok Sabha) on paragraphs 4.07 (iv) of C&AG's
Report, 1980-81 relating to 'Incorrect valuation of unquoted
shares-Processing of recommendations at paras 1.24 and
1.25.

Ministry of Finance, Department of Revenue (Central Board of Direct Taxes) may please refer to the correspondence resting with their U.O. No. 155/50/84-TPL dated the 29th may, 1984 on the subject noted above seeking comments of this Department to the recommendations made by the public Accounts Committee in paragraphs 1.24 and 1.25 of the 203rd Report (1983-84).

2. Recommendations of the Public Accounts Committee for amendment of the Companies Act, 1956, as mentioned in the afore-said U.O. of the Department of Revenue, have been thoroughly examined in this Department. This Department's views are as under:—

- (a) It is noticed that the recommendations of the PAC have been made with reference to the administration of the fiscal Act e.g., Income-tax Act, Wealth Tax Act etc. and the computation of tax liability by the tax authorities of the income-tax|wealth tax assesseees (who might be holding shares of companies which are not listed on the stock exchange) in the course of their assessments. It is a settled position in Law that amendment of an enactment is not carried out for the implementation|administration of other enactments. Therefore, if any difficulty is experienced by the tax authorities, owing to lack of uniformity

on the part of the valuers in assessing the value of unquoted shares held by any assessee (corporate or non-corporate), the proper course would be that either suitable statutory rules are framed under the concerned fiscal Acts and/or administrative guidelines are provided by the CBDT to its field offices.

- (b) The balance sheet of a company is a document which sets out the assets|liabilities and the capital of the company. This document, prepared by the management of the company, is primarily meant for the information of the shareholders of the company concerned. The statutory Auditor is required to certify that the balance sheet depicts a true and fair view of the state of affairs of the company in terms of the provisions of Section 211 of the Companies Act, 1956. Accordingly adoption of the suggestion as made, would be inappropriate being not in conformity with the scheme of the companies Act in the matter of compilation and certification of annual accounts of companies.
- (c) In the matter of valuation of shares (and unquoted shares, in particular), any two valuers seldom agree to the same valuation, as there are a number of variables which enter for consideration, e.g. contingent liabilities, accrued income not actually received, realisability prospects of book debts and loans and advances, value of intangibles like patents, trade marks quota rights etc. and hidden assets like goodwill. Besides, the valuation of shares of closely held companies may also vary, depending upon purpose of, and circumstances surrounding the valuation, e.g. whether a controlling block is sold or the sale is a distress sale. Even in the application of the generally accepted methods for valuation, viz. asset backing and/or yield basis, the valuation may vary, depending upon whether the assets are taken on replacement cost basis and/or the yield rate adopted with reference to the particular industry.
- (d) There is a very large segment of the corporate sector viz. about 97 per cent of the total companies at work whose shares are not quoted on the stock exchange. An obligatory provision of the nature, as suggested, would be unduly onerous for them,
- (e) In so far as the Wealth Tax assessment under the Wealth Tax Act is concerned. it appears that the manner of com-

putation of market value of unquoted preference Shares and unquoted equity shares of companies (other than investment companies) stands provided in the Wealth tax Rules (Rule 1C and 1D) framed under the Wealth Tax Act. In the case there is any lacuna in the said law or rules framed thereunder for the valuation of unquoted shares held by any assessee, it will, perhaps be more appropriate for the CBDT to consider suitable amendment therein, rather than to seek amendment of the Companies Act.

3. In view of the aforesaid, it would be inexpedient to make any amendment in the Companies Act, 1956 so as to provide the manner of computation of value of shares of companies which are not listed on the stock exchange and/or to have the valuation of the shares of such companies stated by way of a note in their balance sheets duly certified by the statutory auditors. Having regard to the purpose in view the most appropriate course would be that the mode of valuation of unquoted shares be provided under the relevant fiscal Act, and not through the amendment of the Companies Act, 1956.

4. This issues with the approval of Minister of Law, Justice and Company Affairs.

Sd|-Sooraj Kapoor
Joint Director (Accounts).

CHAPTER V
RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF
WHICH GOVERNMENT HAVE FURNISHED INTERIM
REPLIES

—NIL—

NEW DELHI;
29 April, 1966
9 Vaisakha, 1908 (Saka)

E. AYYAPU REDDY,
Chairman,
Public Accounts Committee.

PART II

MINUTES OF THE 56TH SITTING OF THE PUBLIC ACCOUNTS
COMMITTEE HELD ON 25-4-1986.

The Committee sat from 15.30 hrs. to 17.00 hrs. in Room No. 50, Parliament House, New Delhi.

PRESENT

- Shri Girdhari Lal Vyas—*In the Chair*
2. Shri J. Chokka Rao
 3. Shrimati Prabhawati Gupta
 4. Shri Vilas Muttemwar
 5. Shri G. Devaraya Naik
 6. Shri Rajmangal Pande
 7. Shri Simon Tigga
 8. Shri Ramanand Yadav

SECRETARIAT

1. Shri N. N. Mehra—*Joint Secretary*
2. Shri K. H. Chhaya—*Chief Financial Committee Officer*
3. Shri Brahmanand—*Senior Financial Committee Officer*
4. Shri O. P. Babal—*Senior Financial Committee Officer*

REPRESENTATIVES OF THE C&AG OF INDIA

1. Shri T. M. George—Addl. Dy. C&AG (Reports—Central)
2. Shri B. Sengupta—D.A.O.F. Calcutta
3. Shri C. V. Srinivasan—Director of Audit (Air Force and Navy), New Delhi.
4. Shri C. P. Mittal—D.A. CW&M, New Delhi.
5. Shri P. K. Bandyopadhyay—Director of Receipt Audit—II.
6. Shri K. Krishnan—Joint Director Receipt Audit—I
7. Shri N. R. Rayalu—Joint Director (Reports—Central).
8. Shri V. S. Jakhmola—Joint Director.

2. The Committee in the absence of the chairman requested Shri Girdhari Lal Vyas to act as Chairman for the sitting under Rule 258(3) of the Rules of Procedure and Conduct of Business in Lok Sabha.

3. The Committee then considered and adopted the following draft Report with some amendments/modifications as shown in Annexure I:—

(i) Draft Report on Action Taken on recommendations contained in 203rd Report of PAC (7th Lok Sabha) regarding Incorrect Valuation of Unquoted Equity Shares and effect of change of previous year.

(ii)	*	*	*	*
(iii)	*	*	*	*
(iv)	*	*	*	*
(v)	*	*	*	*

4. The Committee authorised the Chairman to finalise the draft Report in the light of amendments suggested by the Audit as a result of factual verification of the draft Report and present the same to the House.

The Committee then adjourned.

ANNEXURE I

Modifications/Amendments made by Public Accounts Committee in the Draft Report on Action Taken by Government on recommendations contained in 203rd Report of Public Accounts Committee (7th Lok Sabha) regarding incorrect valuation of unquoted equity shares and effect of change of previous year

Page	Para	Line	For	Read
8	1.10	14	feasible	advisable
9	1.11	7	assessee	assessees

APPENDIX

Statement of Recommendations and Observations

Sl. No.	Para No.	Ministry/ Deptt.	Recommendation/Observation
1	2	3	4
1	1.7	Finance (Revenue)	<p>In their earlier Report the Committee had pointed out that heavy under-valuation had been occurring in the valuation of unquoted equity shares of private companies under Rule 1D of the Wealth Tax Rules which did not take into account the hidden reserves of the private companies but also of other loopholes contributing to the under-valuation of unquoted equity shares of private companies pointed out by the Committee from time to time.</p>
2	1.8	-do-	<p>The Ministry of Finance (Department of Revenue) have, in their action taken note, stated, <i>inter alia</i>, that "with the raising of the exemption limit for the purposes of wealth tax to Rs. 2.5 lakhs and the reduction in the maximum marginal rate of wealth tax to 2 per cent, the motivation for avoidance of wealth tax through valuation of shares would not be as strong now as it was when the draft Wealth Tax (Amendment) Rules, 1981, were published. Further, the problem relating to avoidance of wealth tax through transfer of assets by individuals to closely held companies has since been attempted to be tackled by a limited levy of wealth tax on</p>

certain assets of the closely held companies under Section 40 of the Finance Act, 1983". The Ministry have, therefore, decided with the approval of the Finance Minister not to accept the recommendation of the Committee.

3 1.9 Finance (Revenue)

Valuation of shares and avoidance of wealth tax are two different issues and the raising of exemption limit for the purposes of wealth tax by no means, is an answer to the real problem of undervaluation of unquoted equity shares. The basic principle under the Wealth Tax Act for the valuation of shares is the market value. The Committee had been pointing out from time to time since the year 1977, the loopholes in the manner of valuation of unquoted equity shares. The Committee learn that the CBDT have proposed amendments to the Wealth Tax Rules, 1957 through the Draft Wealth Tax (Amendment) Rules, 1986 issued on 31 March, 1986. The Committee are surprised to note that their recommendations have not been considered while framing the Draft Rules. It seems that the Ministry have not relied on their experience and no earnest attempt has been made to plug the loopholes. The Committee hope that the Ministry would reconsider their stand in the matter. The Committee would like the Ministry to undertake a study of the cases involving incorrect valuation of shares of private companies with a view to identifying the ambiguities and loopholes in the rules which were largely responsible for unquoted equity shares

being undervalued. While doing so, they should keep in view the observations of the Committee and the comments of the Audit so far on the subject. On the basis of study so made, suitable provisions or amendments should be incorporated in the draft Wealth Tax Rules under consideration of the Ministry.

4 1.10 -do-

In order to secure uniformity in the area of valuation of unquoted equity shares of closely-held companies, the Committee had also recommended amendment of the Companies Act, requiring the companies to indicate the value of unquoted shares, as certified by the auditors in a footnote in their balance sheets. The Committee have been informed that the Department of Company Affairs is not agreeable to the amendment of the Companies Act for the reason that the problem regarding valuation of unquoted equity shares should be resolved through the amendment of the Direct Tax Laws and not through the amendment of the Companies Act. The Committee feel that if it has not been found advisable to amend the Companies Act, the alternate course with the Ministry of Finance would be to have recourse to the amendment of the provisions of the Wealth Tax Rules. The Committee suggest that the Wealth Tax Rules be so amended as to provide that the shares of private companies be valued every year by the assessing officer assessing the companies and information regarding the value arrived at, circulated to all the assessing officers having jurisdiction over the

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assessment of the shareholders of the companies. This will undoubtedly go a long way in eliminating the multiplicity of assessments at the hands of different assessing officers, of the value of shares held by various shareholders in the same company.

5 1.11 Finance (Revenue)]

The Committee also suggest that in case the assessee claims that his shares have been overvalued by the assessing officer, the Government should have a right to acquire the shares at the value claimed by the assessee. This will no doubt act as a deterrent to the unscrupulous assesseees in the matter of valuation of shares.
