

**TWO HUNDRED AND THIRD
REPORT
PUBLIC ACCOUNTS COMMITTEE
(1983-84)**

(SEVENTH LOK SABHA)

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

**MINISTRY OF FINANCE
(DEPARTMENT OF REVENUE)**

[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]

Presented in Lok Sabha on . . .
Laid in Rajya Sabha on .

**LOK SABHA SECRETARIAT
NEW DELHI**

April, 1984/Chaitra, 1905 (Saka)

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PUBLIC ACCOUNTS COMMITTEE

(1983-84)

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*Ceased to be Members of the Committee consequent on their retirement from the Rajya Sabha with effect from 2 April, 1984.

INTRODUCTION

I, the Chairman of the Public Accounts Committee, as authorised by the Committee, do present on their behalf this Two Hundred and Third Report of the Committee on paragraph 4.07(iv) & 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'.

2. The Report of the Comptroller and Auditor General of India for the year 1980-81, Union Government (Civil), Revenue Receipts Volume II, Direct Taxes was laid on the Table of the House on 31 March, 1982.

3. Heavy under-valuations have been occurring in the valuation of unquoted equity shares of companies under Rule 10 of Wealth Tax Rules which does not take into account the hidden reserves of companies. In January 1982, the Committee were informed that the Central Board of Direct Taxes had framed draft rules in substitution of Rule 10 and invited public comments thereon. In this Report, the Committee have expressed the hope that the new rules will be finalised and promulgated without further delay and will take due care of not only the hidden reserves of private companies but also of other loop-holes contributing to under-valuation of unquoted shares of private companies.

The Committee find that under the existing arrangements, different assessing officers may 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. In the Committee's view, the magnitude of the problem requires a bold approach to the question of valuation of unquoted shares. The Committee have recommended that the Companies Act should be immediately amended in order to ensure that valuation of unquoted shares of a company is indicated as a footnote in the balance sheet of the company and it is certified by the Auditor.

4. The Committee have already recommended, in another context, the setting up of an autonomous valuation authority, in Paragraph

3,79 of their 101st Report (7th Lok Sabha). In this Report the Committee have recommended immediate setting up of such a Centralised Valuation Authority under the CBOT, which in the opinion of the Committee, should set the lead for such a scientific administration of tax laws in the areas of valuation. This is necessary to complement a decentralised system of certification of valuation of unquoted shares of companies by Chartered Accountants.

5. The Public Accounts Committee (1983-84) considered and finalised this Report at their sitting held on 2 April, 1984. Minutes of the sitting form Part II of the Report.

6. A statement containing conclusions and recommendations of the Committee is appended to this Report (Appendix). For facility of reference, these have been printed in thick type in the body of the Report.

7. The Committee place on record their appreciation of the assistance rendered to them in the examination of this paragraph by the office of the Comptroller and Auditor General of India.

8. The Committee would also like to express their thanks to the officers of the Ministry of Finance (Department of Revenue) for the cooperation extended by them in giving information to the Committee.

NEW DELHI:
March 9, 1984

Chaitra 20, 1905 (Saka)

SUNIL MAITRA
Chairman,
Public Accounts Committee.

REPORT

PART I

CHAPTER I

Incorrect valuation of unquoted shares

Audit Paragraph:

In the wealth-tax assessments of three discretionary trusts, the value of unquoted equity shares in a private limited company was taken at Rs. 2,902 per share in respect of assessment year 1973-74. In the case of one of these trusts, the value of the shares in another newly incorporated investment company was taken at Rs. 56 per share in respect of the assessment year 1974-75. The value of shares in yet another private limited company was taken at Rs. 1,162 per share (in respect of assessment year 1973-74) while valuing the 40 shares held by another individual assessee though 180 shares in the same company held by one of the trusts of which the individual was the sole beneficiary were valued at Rs. 2,211 per share. The valuation of all these shares had been referred to the departmental Valuation Officer who had valued the shares of the three companies at Rs. 7,400 per share (as on 30 June 1973 as against Rs. 2,902), Rs. 200 per share (as on 31 March 1975 as against Rs. 56) and Rs. 3,650 per share (as on 31 March 1973 as against Rs. 1,162/2,211) respectively. However, the valuations done by the departmental Valuation Officer were not adopted in the wealth-tax assessments and this resulted in under-assessment of wealth totalling Rs. 56.89 lakhs and consequent short levy of wealth-tax on the three trusts and the one beneficiary, by Rs. 3,06,682 in the aggregate in respect of the three assessment years 1973-74 to 1975-76.

1.2 The paragraph was sent to the Ministry of Finance in September, 1981 which has in reply stated (January 1982) that the instructions of 1967 are going to be replaced by new rules.

[Paragraph 4.07 (iv) 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 (pp. 186-187)]

1.3 The Ministry of Finance (Department of Revenue) had furnished the following reply to Audit *vide* Ministry's D.O. letter No. F. 236/671/81-A&PAC-I dated 6 January, 1982:

"The Wealth-tax Officers are bound by the Board's instructions of 1967. However, the instructions are going to be replaced by rules. The draft rules for the valuation of unquoted equity shares of investment companies have been notified for general information on person likely to be affected thereby. A copy of the draft rules has also been sent to the Audit for their comments. The rules will be finalised after considering the comments, if any, received in this regard."

1.4 The following assesseees and the assessment years, noted against each are involved in the cases referred to in the Audit paragraph:

1. Bharatidevi Sarabhai Trust No. 1—Assessment year 1973-74.
2. Suhrid Sarabhai Trust No. 3—Assessment years 1973-74 and 1974-75.
3. Leena Sarabhai Trust—Assessment year 1973-74.
4. Smt. Anarkali Tarabhai—Assessment year 1975-76.

1.5 The name of the companies whose unquoted equity shares are involved and the nature of the companies as furnished by the Ministry of Finance (Department of Revenue) are given below:

- | | |
|---|---|
| 1. Karamchand Premchand Pvt. Ltd.
(K.P.P.L.) | Non-investment company upto 31-12-73 and thereafter it has merged with Shahibag Entrepreneurs Private Limited (SEPL) and manufacturing units of KPPL were transferred to subsidiaries and so SEPL is an investment company. |
| 2. Shahibag Entrepreneurs Private Ltd. (S.E.P.L.) | |
| 3. Sarabhai M. Chemicals Private Limited | Non-investment company upto 31-3-72. Later on manufacturing activities were transferred to Telerad Private Limited. So far assessment year 1973-74 it is an investment company. |
| 4. Kalindi Investments Private Limited. | Sarabhai M. Chemicals Private Limited was changed to Kalindi Investments Private Limited from 1-1-1973 and it is an investment company. |

1.6 The Committee enquired whether the assesseees were connected as members or settlers of numerous private family trusts of the same industrial house in control of the companies concerned. The Ministry of Finance, (Department of Revenue) have replied:

“The assesseees (mentioned in paragraph 1.4) are three trusts and one is the individual assessee and so the question does not apply. However, the beneficiaries of the trusts can be said to be connected.”

1.7 The Ministry of Finance (Department of Revenue) indicated that the number of private family trusts in the Sarabhai group as in September, 1982 was 2024.

1.8 The following are the details of the valuation of the unquoted equity shares in respect of the value adopted in assessments and as determined by the Departmental Valuation Officer:

S. No.	Name of the assessee	Assessment year	No. of shares	Name of the Company	Value per shares adopted in Wealth Tax Assessments	*Value of shares determined by Departmental Valuation Officers	
					Rs.	Rs.	
1.	Bharatidevi Sarabhai Trust No. 1	73-74	126	K.P.P. Ltd.	2902	7400	(for Income-tax purpose)
2.	Suhrid A. Sarabhai Trust No. 3	73-74	270	Do.	2902	Do.	
	Do.	74-75	9720	S.E.P. Ltd.	56	205	(for Wealth Tax purpose)
3.	Leena Sarabhai Trust	73-74	478	K.P.P.Ltd.	2902	7400	(for Income Tax purpose)
4.	Anarkali Sarabhai	75-76	40	Kalindi Investments Pvt. Ltd.	1162	3650	(for Income Tax purpose)
	Do.	Do.	186	Do.	2211	Do.	

(Held by Anarkali Sarabhai Trust—the assessee being sole beneficiary)

*None of these valuations were made for assessment year 1973-74.

1.9 In regard to the valuation adopted in the case of shares of Messrs. K.P.P. Ltd. and KIPL (formerly known as Sarabhai M. Chemicals), the Ministry of Finance (Department of Revenue) explained the position as follows:

Value of shares of M/s. KPPL: Regarding the value of shares of M/s. KPPL in the wealth-tax assessment of the three assessees, for the assessment year 1973-74 it was adopted at Rs. 2902/- as per rule 1D of the Wealth-tax Rules since M/s KPPL was a non-investment company for the assessment year 1973-74.

A reference was made to the Departmental Valuation Officer in the case of Suhrid A. Sarabhai (HUF) under Sec. 55A of the Income-tax Act for the purpose of capital gains. The Departmental Valuation Officer determined the value of Rs. 7400/- which was adopted for the purpose of Income-tax. Shri Suhrid A. Sarabhai went in appeal against the valuation. The assessment was set aside by the Commissioner of Income-tax (Appeals). A fresh assessment order was made which was cancelled by the Commissioner of Income-tax (Appeals). On further appeal the Income Tax Appellate Tribunal in their order dated 26-5-1981 sent back the appeal to Commissioner of Income Tax (Appeals) before whom it is pending.

While the date of valuation for the Wealth-tax purposes for the assessment year 1973-74 was 31-3-1973, the date of valuation for the purpose of capital gains of the Income-tax Act, was 31-12-1973 for the assessment year 1974-75. Several transactions took place in between the two dates, contributing to high rise in the share value. The biggest of all was accrual of goodwill of Rs. 10 crores as on 30-6-73 on transfer of manufacturing units to subsidiary 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. Obviously, the value of Rs. 7400/- which is on a later date cannot be adopted for wealth-tax purposes.

However, in the Ministry's reply dated 16-1-1982, it was incorrectly stated that the shares of all the three companies were valued in accordance with the Board's instructions in Circular No. 2-WT of 1967, dated 30-10-67. It is now ascertained that the shares were valued in accordance with Rule 1D of the Wealth-tax Rules in the case of M/s. KPPL.

Value of shares of M/s. K.I.P.L.

In the Wealth-tax assessment of Smt. Anarkali Sarabhai the value of shares of M/s Sarabhai M. Chemicals Pvt. Ltd. now known as K.I.P.L., was adopted at Rs. 1162/- as on 31-3-1973 (assessment year 1973-74) and at Rs. 2211/- as on 31-3-1975 (assessment year 1975-76).

A reference was made to the Departmental Valuation Officer in the case of Suhrid A. Sarabhai ((HUF) and Gautam Sarabhai to determine the valuation of shares for the purpose of determining capital gains under Section 55A of the Income-tax Act. The Departmental Valuation Officer determined the value at Rs. 3650/- per share as on 31-12-1973 which was adopted in the Income-tax assessments. The value adopted for the Income-tax purposes was set aside by the Commissioner of Income Tax (Appeals). A fresh assessment was made on 21-3-1980 and on appeal, Commissioner of Income Tax (Appeals) deleted the capital gains. The Department's appeal against this order is pending before the Income Tax Appellate Tribunal. In the wealth-tax assessment of Smt. Anarkali A. Sarabhai the shares of K.I.P.L. were treated as that of an investment company and were valued as per Board's instructions.

The value determined by the Departmental Valuation Officers cannot be adopted for wealth tax as the valuation was made under the Income Tax Act. The details regarding the value of shares of M/s. S.E.P.L. are being verified and a further communication may be awaited.

In respect of Suhrid A. Sarabhai Trust No. 3 for the assessment year 1974-75, which was under verification, a reply was sent *vide* Ministry's letter dated 13-9-1982:

"On further verification of facts, the Commissioner of Income Tax has reported that in the case of Suhrid A. Sarabhai Trust No. 3 for wealth-tax assessment year 1974-75 (valuation date 31-3-1974), the shares of Shahibag Entrepreneurs Private Ltd. (SSPL) were adopted at Rs. 56/- per share. However, the value of the shares of this company for the wealth-tax assessment year 1974-76 was adopted at Rs. 205/- in the case of Suhrid A. Sarabhai (HUF) on the basis of the Departmental Valuer's Report. Hence, the audit objection in this case of assessee is accepted by the Ministry.

The wealth-tax assessment of Suhrid A. Sarabhai Trust No. 3 has been reopened under Section 17. Further report regarding completion of remedial action and additional demand raised and collected may be awaited from Director of Inspection (Audit)."

1.10 In regard to the reply of the Ministry relating to shares of M/s. K.P.P.L. about the accrual of goodwill on transfer of manufacturing units to subsidiary companies, the Revenue Audit have conveyed the following observations to the Ministry of Finance (Department of Revenue) *vide* their D.O. letter No. 955-Rec.A-III/217-81/PAC dated 10 November, 1982:

"The amount of goodwill (Rs. 10 crores) which existed earlier for the assessment year 1973-74 also but were not disclosed in the balance-sheets of the company indicates the extent of heavy under-valuation which is occurring in the valuation of unquoted equity shares of companies under Rule 1D which does not take into account the secret reserves of companies. This defect in the Rule was pointed out by Audit earlier also and it subsists."

1.11 The Committee desired to know details of the cases wherein references were made to the Departmental Valuation Officer for valuation of the respective unquoted equity shares. The Ministry of Finance (Department of Revenue) stated:

"A reference was made to the Valuation Officer of the Department in the case of M/s. Suhrid Sarabhai (HUF) for determining the value of shares of M/s. Karamchand Premchand Private Limited for the purpose of capital gains under the Income-tax Act. The valuation officer valued the shares at Rs. 7,400/- per share as on 31-12-1973, *vide* his order dated 22-2-1977.

Another reference was made to the Valuation Officer of the Department in the case of M/s. Suhrid Sarabhai (HUF) for valuation of the shares of M/s. Shahibag Entrepreneurs Private Limited as on 31-3-1974 and 31-3-1975 for wealth-tax purposes. The Valuation Officer valued the shares at Rs. 205 per share as on 31-3-1974 and Rs. 200 per share as on 31-3-1975 *vide* his order under Section 16A(5) dated 5-3-1979.

The third reference was made to the Valuation Officer of the Department for valuation of shares of Kalindi Investments Private Limited for assessment year 1974-75 under

the Income-tax Act in the case of Shri Gautam Sarabhai. The Departmental Valuer valued the shares at Rs. 3,650 per share as on 31-12-1973 *vide* his order dated 24-1-1977."

1.12 Asked if the persons in whose cases references were made for departmental valuation were connected to the persons/family group in control of these companies and whether the latter were also assessed in the same ward, the Ministry of Finance (Department of Revenue) replied:

"They can be said to be inter-connected. However, they are not assessed in the same ward M/s. Suhrid Sarabhai (HUF) is assessed in Companies Circle III, Ahmedabad and Shri Gautam Sarabhai is assessed in Companies Circle XI, Ahmedabad."

1.13 The Committee enquired about the point of time when the valuation reports were received in the present ward *viz.*, Companies Circle XI, Ahmedabad. In reply, the Ministry of Finance (Department of Revenue) stated:

"This Circle was created with effect from 1st May, 1977, whereas two of the reports are dated 24th January, 1977 and 22nd February 1977. However the specific information as to what date this particular Circle received the valuation report in question is being ascertained from the Commissioner of Income-tax."

1.14 The following note furnished by the Ministry of Finance (Department of Revenue) explains the contents of Circular No. 1177 dated 20 May, 1978:

"The instructions are regarding whether the value of unquoted equity shares of a company as determined by the Valuation Officer in the case of one shareholder of the company should as a matter of administrative policy be uniformly adopted by the Department in the assessment of other shareholders of the same company without obtaining a fresh valuation from the Valuation Officer under Section 16A in each case. It was explained that if the assessee were to object to the adoption in his case of the value as determined by the Valuation Officer in another case, the Department will be bound to make a fresh reference to the valuation officer. While this may be so, the Commissioners of Income-tax were required to circulate copies of fair and correct valuation reports to the officers

in his charge as well as to the other Commissioners for being followed wherever necessary in respect of other shareholders."

1.15 The Committee desired to know if these assessments were made after the issue of Board's instructions referred to above. In reply, the Ministry of Finance (Department of Revenue) affirmed the position and stated:

".....the assessments were made after the Board's Instruction No. 1177, dated 20-5-78 i.e. 28-10-78, 27-11-78, 24-2-79 and 28-3-80."

1.16 Asked whether the instructions were compiled within the Commissioner's charge in which Ward Company Circle XI, Ahmedabad falls, the Ministry of Finance stated that "the Commissioner of Income-tax has not circulated orders of valuation of any shareholders in his charge."

1.17 The Committee desired to know which Commissioner of Income-tax in Ahmedabad was designated to scrutinize the departmental valuation reports and to circulate the values for adoption in other wards/charges in terms of the Board's instructions and whether these instructions were being generally followed. In reply, the Ministry of Finance (Department of Revenue) stated:

"The Commissioner of Income-tax has not circulated orders of valuation of any share holders in his charge. As per Instruction No. 1177, the Board desired that the Commissioner of Income-tax concerned should apply his mind as to the correctness/fairness of the valuation whenever valuation of shares of a Company falling in the jurisdiction of that Commissioner has been made by a Valuation Officer. It would thus be seen that no single Commissioner as such has been designated to scrutinise under these instructions."

1.18 The Committee learn from Audit that there are at present over 50,000 private companies and investment companies whose shares are not quoted.

1.19 The Finance (No. 2) Act 1980 introduced certain amendments with effect from 1-4-1980 under Section 7(1) and 21 of the Wealth-tax Act, 1957 and Section 164(1) of the Income-tax Act, 1961 to provide against avoidance of direct taxes through the medium of multiplicity of private family trusts. In this context, the Committee desired to know the effect of the amended provisions

on the tax liability of the trusts in the Sarabhai group. The Ministry of Finance (Department of Revenue) stated:

"In no case, the Wealth-tax assessments Act after the amendment by Finance No. 2 Act of 1980 have been made and as such it is not possible to state the quantum of tax effect in those trust cases. As regards the Income-tax assessments made in this ward for assessment year 1980-81 onward in the cases of the trusts, there is no effect in tax because either the beneficiaries are directly taxed or the trusts have no income."

1.20 The Committee enquired if any studies had been conducted on the effect of the aforesaid amendments as also in regard to new devices, if any, adopted to counter the effect of these amendments. The Ministry of Finance (Department of Revenue) replied:

"No study has been made in this regard so far."

1.21 Asked if the Board considered it expedient to have such a study conducted, the Ministry of Finance (Department of Revenue) stated:

"The Commissioner of Income-tax, Ahmedabad and the Directorate of Inspection (Special Investigation) have been asked to make a study as aforesaid."

1.22 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. 7,400/- 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 subsidiary companies. This amount is 300% 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 I D of Wealth-tax Rules which does not take into account the hidden reserves of companies. The loopholes in Rule I 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 (Fifth Lok Sabha) for review and rectification. In January, 1982, the Committee were informed* that the Board had framed draft rules in substitution of Rules I 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

*101st Report (Seventh Lok Sabha) paragraph 3.118.

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.

1.23 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 charges 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.

1.24 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 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 bind-

ing 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 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.

1.25 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.

CHAPTER II

EFFECT OF CHANGE OF PREVIOUS YEAR

Audit Paragraph

2.1 Under the provisions of the Wealth-tax Act, wealth-tax is chargeable in respect of each assessment year on the net wealth of the assessee as on the valuation date (which has been defined in the Act as the last date of the 'previous year' as defined in the Income-tax Act) corresponding to that assessment year. Date of commencement of previous year once chosen and used by the assessee cannot be changed except with the consent of the Income-tax Officer and the change may be allowed by him upon such conditions as he may impose. Since wealth-tax is chargeable on net wealth, as on a particular date, the Board had issued executive instructions in 1968 and in 1980 to the effect that Income-tax Officers, while agreeing to any request of assesseees for change in the 'previous year' should ensure that liability to wealth-tax would not be adversely affected.

2.2 An Income-tax officer permitted a charitable trust related to an industrial group to extend its accounting year ending on 31 March 1974 to end on 30 June 1974 and by reason of such change no wealth-tax assessment could be made in respect of the assessment year 1974-75. Consequently, wealth valued at Rs. 72,26,500 as assessed in respect of the assessment year 1973-74 escaped assessment to wealth-tax in respect of the assessment year 1974-75, resulting in loss of revenue of about Rs. 4,88,000.

[Paragraph 4.15 of the Report of the Comptroller & Auditor General of India for the year 1980-81, Union Government (Civil), Revenue Receipts, Vol. II, Direct Taxes (pp. 204-205).

2.3 Valuation date in relation to any year for which assessment is to be made under the Wealth-tax Act, 1957 means the last day of the previous year as defined in Section 3 of the Income-tax Act, if an assessment were to be made under that Act for that year provided that:

“In the case of a person who is not an assessee within the meaning of the Income-tax Act, the valuation date for the purposes of this Act shall be the 31st day of March immediately preceding the assessment year.”

2.4 The assessee referred to in the Audit Paragraphs is M/s. Mohini Thapar Charitable Trust, Calcutta.

The trust belongs to the Thapar Group. The corpus of the trust as per the Income-tax return for the assessment year 1979-80 is the trust fund of Rs. 55 lakhs. This has been invested in land, shares and advances and deposits in banks.

2.5 Asked if the assessee is registered as a charitable trust, the Ministry of Finance (Department of Revenue) replied in the affirmative and stated:

“The assessee is registered as a charitable trust under Section 12A of the Income-tax Act.”

2.6 In regard to the reasons for its failure to get exemption from income-tax and wealth-tax, the Ministry of Finance stated:

“Reasons for assessee’s failure to get exemption from income-tax and wealth-tax are violations of provisions under Section 13(1)(c) and 13(2)(h) of the Income-tax Act, 1961.”

2.7 The Committee enquired whether failures to comply with the provisions of Sections 13(1)(c) and 13(2)(h) are wide-spread amongst charitable trusts. In reply, the Ministry of Finance (Department of Revenue) stated:

“There is no material available with the Ministry to confirm that such failures are wide-spread amongst charitable trusts.”

2.8 The change of account period was from 31 March to 30 June and the same was allowed by the Income-tax Officer on 27-3-1974.

2.9 The reasons for the change in income-tax previous year given by the assessee, as communicated by the Ministry, are as follows:

“The Income from our investments in shares and interest on loans/deposits is generally received by us after March and it makes it extremely difficult for us to make the requisite charities in absence of actual funds being made available to us though the income is taken on accrual basis.

The donors also find it difficult to make donations unless their accounts are finalised.

Since our accounts are maintained at a very nominal charge by Karam Chand Thapar and Bros. Private Ltd. whose accounts also end in March, it becomes extremely difficult to ensure early finalisation of our accounts since their staff is otherwise busy with their own closing.”

2.10 In 1968, a case had come to the notice of the Central Board of Direct Taxes wherein as a result of the Income-tax Officer permitting the assessee to change its 'previous year' ending on 31-3-1957 to the year ending on 30-6-1957, there was no income-tax assessment for 1957-58 and the income of 15 months *i.e.* from 1-4-1956 to 30-6-1957 was assessed for the assessment year 1958-59, and the assessee company contended that no wealth-tax assessment could be made for the assessment year 1957-58. The Central Board of Direct Taxes issued a circular dated 4-9-1968 to the effect that the Income-tax Officers should ensure that while agreeing to any request for change in the 'previous year' the liability to wealth-tax is not thereby adversely affected.

Similar cases came to the notice of the Board in 1976 and 1980 as well and the Board issued Circulars dated 26 August 1976 and 21 July 1980.

2.11 The following statement furnished by the Ministry of Finance shows the income and net wealth assessed, income-tax and wealth-tax levied and collected in the case cited under Audit Paragraph for the assessment years 1970-71 onwards:

Income Tax

Assessment year	Income assessed	Income tax	
		Levied	Collected
	Rs.	Rs.	Rs.
1970-71	Nil	Nil	81,194*
1971-72	5,41,480	4,82,016	4,82,016
1972-73	4,44,265	3,90,569	3,90,569
1973-74	3,31,300	2,95,394	2,95,394
1974-75	Nil	Nil	Nil
1975-76	4,31,960	3,21,872	3,21,872
1976-77	36,659	8,841	83,544*
1977-78	38,112	7,814	52,127*
1978-79	72,640	27,775	60,680*
1979-80	1,14,870	55,340	66,247*

Note : 1. * Amounts collected in excess are partly adjusted towards demand for the earlier years and are partly refundable.

2. No return was filed for the Assessment year 1974-75 due to change in the accounting year.

Wealth Tax

Assessment Year	Net wealth assessed	Wealth tax	
		Levied	Collected
	Rs.	Rs.	Rs.
1970-71	---	---	---
1971-72	---	---	---
1972-73	---	---	---
1973-74	72,26,481	4,88,118	4,89,957*
1974-75	Nil	Nil	Nil
1975-76	44,69,525	2,77,760	2,77,760
1976-77	1,93,230	2,896	2,895
1977-78	2,81,202	4,080	4,080
1978-79	4,35,220	6,026	6,026
1979-80	4,96,980	7,455	7,455

Note : 1. *Excess tax collected is refundable.

2. No return was filed for the Assessment Year 1974-75 due to change of the accounting year.

2.12 Asked to state what is the duty cast upon the Income-tax officer to safeguard the interest of the revenue while allowing change in the income-tax 'previous year', the Ministry of Finance replied:

"A duty is cast upon the ITOs to 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 change of accounting year in a manner that would cause detriment to the revenue. In appropriate cases, they have been instructed to take prior approval of the IAC under Section 144A. In this connection, the Board has also issued Instruction No. 1002 dated the 26th August 1976."

2.13 In terms of Circular dated 26 August 1976, the Commissioners of Income-tax were required to review all cases where consents given by the I.T.O.s from 1-9-1975 onwards involved loss of revenue including undue deferment of payment of (advance tax) and to take action wherever necessary, under Section 263 to cancel the consent of the Income-tax Officer, if it is found to be prejudicial to the revenue. The audit objection in the aforesaid case was pointed out to

the Income-tax Officer on 6-2-1980. In this context, the Committee enquired if the omission to safeguard the interest of revenue could be rectified by setting aside the order of change in the income-tax 'previous year' under Section 263 of the Income-tax Act 1961. In reply, the Ministry of Finance stated:

"As the order of the Income-tax Officer permitting change of accounting year was passed on 27-3-1974 the time limit to set aside the order u/s 263 of the Income-tax Act expired by 26-3-1976 *i.e.*, before the Audit objection. It would, however, be seen that as against the loss of Wealth-tax, Income-tax has been assessed on an income of 15 months as against the usual 12 months."

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 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 Officer. 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 interests of revenue in such cases.

2.15 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 the assessee trust for appropriate action. The Committee would like to have a further report in the matter.

NEW DELHI;
April 9, 1984

Chaitra 20, 1960 (Saka)

SUNIL MAITRA,
Chairman,

Public Accounts Committee.

PART II

**Minutes of the 68th Sitting of the Public Accounts Committee (1983-84)
held on 2 April, 1984 in Committee Room No. 50, Parliament House,
New Delhi**

MINUTES OF THE 68TH SITTING OF THE PUBLIC
ACCOUNTS COMMITTEE (1983-84) HELD ON
2 APRIL, 1984 IN COMMITTEE ROOM NO. 50,
PARLIAMENT HOUSE, NEW DELHI

The Committee sat from 1500 to 1920 hours.

The following were present:

1. Shri Bhiku Ram Jain—*In the Chair*
2. Shri G. L. Dogra
3. Shri Jamilur Rahman
4. Shri Uttam Rathod
5. Shri G. Narsimha Reddy
6. Dr. Sankata Prasad
7. Shri Syed Rahmat Ali
8. Smt. Pratibha Singh
9. Dr. (Smt.) Sathiavani Muthu
10. Dr. Harekrushna Mallick
11. Shri Nirmal Chatterjee

SECRETARIAT

Shri H. S. Kohli—*Chief Financial Committee Officer*
Shri K. K. Sharma—*Senior Financial Committee Officer*
Shri R. C. Anand—*Senior Financial Committee Officer.*

REPRESENTATIVES OF THE OFFICE OF C&AG

Shri R. K. Chandrasekharan—*Deputy Comptroller and
Auditor General of India*
Shri V. Sundaresan—*Director of Receipt Audit-I*
Shri K. N. Roy—*Director of Audit, Defence Services*
Shri A. N. Biswas—*Director of Audit, P&T*
Shri A. N. Mukhopadhyay—*Joint Director, Audit (Re-
ports—Central)*
Shri N. R. Rayalu—*Joint Director (Defence)*
Shri R. S. Gupta—*Joint Director of Audit, Defence
Services.*

Shri R. Balasubramaniam—*Joint Director (Direct Taxes)*
 Shri Gopal Singh—*Joint Director, P&T.*

2. The Committee considered the following draft Reports and adopted the same with certain modifications|amendments as shown in the respective Annexures I to V:*

- (i) Draft Report on paragraph 4.07(iv) and 4.15 of the Report of the C&AG of India for the year 1980-81, Union Government (Civil), Revenue Receipts, Vol. II-Direct Taxes relating to 'Incorrect valuation of unquoted shares' and 'Effect of change of previous year'.

* * * * *

4. The Committee also authorised the Chairman to finalise the Reports after incorporating modifications|amendments arising out of factual verification by Audit and to present the Reports to Parliament.

* * * * *

The Committee then adourned.

*Relevant Annexure I only.

ANNEXURE I

List of modifications/amendments made by the Public Accounts Committee in the draft Report on paragraphs 4.07 (iv) and 4.15 of the Report of the C&AG of India for the year 1980-81 relating to 'Incorrect Valuation of Unquoted shares' and 'Effect of change of Previous year'.

Page	Para	Line	
12	1.22	11-14	<i>Omit</i> the sentence "The Committee understand from Audit.....balance sheets of the company."
14	1.24	6	<i>For</i> "shares of unquoted" <i>Read</i> "unquoted shares".
		16	<i>Omit</i> the words "as the true valuation" <i>after</i> the word "ITO/WTO".
15C	1.25		<i>Omit</i> the sub-paragraph appearing at page 15C.
22	2.14	2-4 from bottom	<i>Omit</i> the portion beginning with "for, whenever a change.....be left out."
23	2.15		<i>Add</i> the following sentence at the end of paragraph 2.15: "The Committee would like to have a further report in the matter".

APPENDIX

(Vide Introduction)

Conclusions/Recommendations

S. No.	Para No.	Ministry/Department	Recommendation
1	2	3	4
1.	1.22	Finance (Revenue)	<p>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. 7,400/- 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 percent 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 I D of Wealth-tax Rules which does not take into account the hidden reserves of companies. The loopholes in Rule I 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 (Fifth Lok Sabha) for review and rectification. In January 1982, the Committee were informed* that the Board had framed draft rules in substitution of Rule I D and invited public comments thereon. The Committee observe that the draft Rules as notified for general information and public comments also contain provisions</p>

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.

2. 1.23 -do-

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 charges 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.

3. 1.24 -do-

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 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 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 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.

4. 1.25 Finance (Revenue)

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.

15

5.

1.24

Finance (Revenue)

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 Officer. 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 interests of revenue in such cases.

29

5.

2.15

-Do-

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 the assessee trust for appropriate action. The Committee would like to have a further report in the matter.

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