* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% **Judgment reserved on: 01 August 2024**
Judgment pronounced on: 14 August2024

\+ ITA 281/2008

RAVI KUMAR SINHA .....Appellant

Through: Mr. Ajay Vohra, Sr. Adv. with Mr. Udit Naresh, Adv.

versus

THE COMMISSIONER OF INCOME TAX .....Respondent

Through: Mr. Puneet Rai, SSC along with Mr. Rishabh Nangia, Advs.

\+ ITA 770/2008

THE COMMISSIONER OF INCOME TAX XIII.....Appellant

Through: Mr. Puneet Rai, SSC along with Mr. Rishabh Nangia, Advs.

versus

RAVI KUMAR SINHA .....Respondent

Through: Mr. Ajay Vohra, Sr. Adv. with Mr. Udit Naresh, Adv.

CORAM:
HON'BLE MR. JUSTICE YASHWANT VARMA
HON'BLE MR. JUSTICE RAVINDER DUDEJA

J U D G M E N T

YASHWANT VARMA, J.

1. The assessee as well as the Commissioner of Income Tax assail the order of the **Income Tax Appellate Tribunal**[1] dated 27 April 2007 and in terms of which the appeals of both of the Department as well as

[1]Tribunal

of the assessee had come to be dismissed. We had by our order of 07 October 2009 admitted these appeals on the following two questions of law:-

> "1. Whether on the facts and circumstances of the case the Tribunal erred in law in confirming addition of Rs.86,28,750/ - as perquisite value of shares granted under Employees Stock Purchase Scheme (ESPS)?
>
> 2. Whether value of stock purchase option exercised by the employee/Assessee is to be reckoned on the date of exercising such option and taxing it for the difference in market price had cost paid by the assessee to its employer?"

2. The question itself stands posited in respect of the allotment of shares in favour of the assessee under an **Employees Stock Purchase Scheme**[2] and which was subject to a lock-in period. Admittedly, under the ESPS, the assessee had been allotted 11,50,500 shares @ INR 15/- per share. Twenty five per cent of that stock was subject to a lock-in period of 12 months while the balance seventy five stood locked-in for 18 months. The share certificates which were handed over to the assessee also carried an appropriate endorsement to the aforesaid effect.

3. It is also undisputed that during the previous Financial Year, the assessee had paid only INR 10.50/- per share against the issue price of INR 15. It is also its case that the employer company out of abundant caution enlisted the services of M/s Ernst and Young and obtained a Valuation Report with respect to the shares in question. The company is also stated to have informed the appellant that the share certificates stood effaced with an endorsement of non-transferability. In terms of the Valuation Report which came to be submitted, a price of INR 22.50/- came to be ascribed for each share.

[2]ESPS

4. While filing his Return of Income, however, the assessee took the position that since the shares were not marketable in view of the lock-in stipulation, the **Fair Market Value**[3] could not exceed the face value of the shares. While examining the said return and assessing the income liable to tax, the **Assessing Officer**[4] held that although the appellant had been allotted shares at a concessional rate of INR 15 per share, the market price as quoted at the relevant time stood at INR 49.45 per share. It accordingly came to conclude that the difference between the two figures, namely INR 34.45 per share, was liable to be taxed as perquisite in terms of Section 17(2)(iiia) of the **Income Tax Act, 1961**[5]. This resulted in an addition of INR 3,96,34,725/- in the hands of the assessee.

5. Aggrieved by the aforesaid, an appeal came to be instituted before the **Commissioner of Income Tax (Appeals)**[6]. The CIT(A), however, took the view that since the shares were subject to a lock-in stipulation and thus not available to be traded or transferred, it would be inappropriate to take the quoted price as appearing on the Stock Exchange for the purposes of determining FMV. However, and bearing in mind the Valuation Report which had been obtained by the employer itself, it held that the FMV should be taken as INR 22.50/- per share. This becomes evident from a reading of Paras 2.6 and 2.7 of the order of the CIT(A) which are extracted hereinbelow:-

> "**2.6.** On the basis of law laid down as above by the Hon'ble Gujarat High Court as also followed by the Hon'ble Delhi High Court in the case of Promila Bali it can safely be inferred that the perquisite value

---

[3] FMV
[4] AO
[5] Act
[6] CIT(A)

of these shares has to be computed by adopting the actual price paid by the appellant i.e. Rs.15/- per share as the fair market value of these shares since there is a total ban on transfer/ sale realization of these shares during the year under consideration. It is my considered view that the fair market value of these shares has to be computed according to the contributions made by the appellant for the acquisition of such non transferable shares. I am fortified in view by the recent decision of the Hon'ble Bangalore Tribunal in the case of the Infosys Technologies Limited v. DCIT (2002) 79 TTJ 598, wherein it has held that it can be interpreted that there exists no market for the shares under lock-in. In other words, no market value can be assigned to such shares. The market value of the shares for the employee is, therefore, defined and remains the price paid by him to be allowed in the case of Wipro Ltd. v. DCIT reported in 80 TTJ 106 holding that where the employee is not in a position to sell the shares during the stipulated time, he cannot meet the conditions of the stock exchange and therefore, it is incorrect to equate the value of the shares so received to the quoted price.

2.7 It is, however, seen that the employer, in order to compute the income under the head "Salary", has obtained a valuation report from experts, M/s Ernst and Young, Chartered Accountant. In their valuation report, the valuer has approached the issue of valuation under different possible methods of valuation. They had determined the value of the equity share allotted by the employer at Rs.22.50 per equity share. The employer had accordingly acted on such determination by an expert and deducted appropriate taxes after treating the difference between the amount by the employee and the value thus determined as a perquisite includible in the income under the head "Salary", The Assessing Officer is accordingly advised to recomputed the value of perquisite in terms of section 17(2)(iiia) of the Act between the fair market value of these shares at Rs.22.50 per share and deduct tax from the actual cost paid by the appellant for acquisition of these share."

6. This led to both the Commissioner as well as the assessee approaching the Tribunal. The Tribunal upon evaluation of the rival submissions which were addressed held as follows:-

"**6.** We have considered the rival contentions, carefully gone through the orders of the authorities below and found from the record that shares were allocated to the assessee under ESPS scheme. The company has charged Rs.15/- per share from the employee. However, as there was a locking period, and the assessee was not at a liberty to immediate resale the shares at open market, the employer company itself got it valued from expert valuer who determined the

fair market value of share at Rs.22.50. Therefore, the value of perquisite in the hands of assessee was taken at Rs.7.50 per share by the employer and tax was accordingly deducted at source. On the basis of market quotation of the shares, the Assessing Officer valued it at Rs.49.95 and accordingly recalculated the perquisite value in the hands of the assessee. There is no dispute to the fact that shares so allocated under the company stock option scheme was with a condition of lock in period. As the shares were not freely transferable at the relevant point of time, there is no any valid reason for taking market value of these shares prevailing at the Bombay and Delhi Stock Exchange. At the very same time, it cannot be said that no benefit has been accrued to the assessee in the form of perquisites, in respect of shares allotted to the assessee in stock option scheme. Even company in which the assessee was Managing Director, also employer of the assessee has taken full precautions to ascertain the value of benefit given to the employees by way of stock option scheme. Thus the employer company had determined the value of the shares by an expert, who by taking into consideration the lock in period of the impugned shares, arrived at a value of Rs.22.50 per share. M/s Ernst & Young have determined the fair market price of these shares at the relevant point of time by taking into account market price, discounted cash flow, net asset value method, and thereafter giving proper weightages for lock in period, the value of shares was arrived at s.22.50. The assessee has not pointed out any fault in the method of arriving at the fair market value of share by M/s Ernst & Young. We, therefore do not find any infirmity in the order of Ld. CIT(A) for taking the fair market value share of Rs.22.50 as arrived at by M/s Ernst I & Young and which has also been taken out by the employer company, basing on which tax at source has also been deducted from the income of the assessee. The case laws cited by Id. AR in ITAT Bangalore Bench in Infosys Technologies Ltd., which was confirmed by the Hon'ble Karnataka High Court, basically deals with the provisions of treatment of assessee in default under provisions of section 201(1) and 201(1A). In the aforesaid case the lock in period was comparatively longer one and after taking into consideration all the facts and circumstances of the case the Tribunal came to the conclusion that assessee company cannot be said to be in default under section 201(1) & 201(1A). However, in the instant case before us the lock in period is very short and by taking the same into consideration vis-à-vis market price, discounted cash flow, net asset value method, an expert has arrived at the fair market value at Rs.22.50 per share, on which the employer has correctly deducted at

> source, therefore, no question of treating the assessee in default arises under section 201(1) & 201(1A). Similarly, in the case of Wipro Ltd., cited by the Id. AR, it was held that assessee company could not be treated to be assessee in default for not deduction of tax at source on ESOP benefit arising its employees and it was held that assessee can be said have acted bona-fide in not deducting the tax on ESOP benefit given to the assessee. Thus, these cases are distinguishable. In case of XYZ reported at 235 ITR 565, it was held that benefit was given to the employee under stock option scheme, is a part of salary, therefore, the same was subject to deduction of tax with reference to the value of perquisite arising on exercise of such action of the employee."

It is the aforesaid decision which has led to the institution of the present appeals.

7. Mr. Ajay Vohra, learned senior counsel appearing for the assessee, submitted that in light of the lock-in period which operated, the concept of FMV could not have possibly been imputed or adopted. According to learned senior counsel, bearing in mind the fact that the shares could neither be traded nor sold, only a notional value could have at best been ascribed to the stock. Mr. Vohra submitted that the Act itself does not contemplate a tax being imposed on notional income. According to Mr. Vohra, the concept of FMV itself contemplates the price being determined with reference to what a capital asset would ordinarily fetch on sale in the open market and on the relevant date. Our attention was drawn to Section 2(22B) of the Act which defines FMV in the following terms:-

> "2(22B)] "fair market value", in relation to a capital asset, means—
>
> (i) the price that the capital asset would ordinarily fetch on sale in the open market on the relevant date; and
>
> (ii) where the price referred to in sub-clause (i) is not ascertainable, such price as may be determined in accordance with the rules made under this Act;"

8. It is in the aforesaid backdrop that Mr. Vohra contended that since there was an admitted restraint on the tradeability of the capital asset, the Department clearly erred in seeking to impose a tax based on the prevailing market price or for that matter on the basis of the Valuation Report submitted by M/s Ernst and Young.

9. Insofar as the Valuation Report is concerned, it was Mr. Vohra's submission that the same had been obtained by the employer of the assessee only out of abundant caution and in order to ascertain its liability with respect to withholding tax obligations. According to learned senior counsel, the Valuation Report thus could not have possibly constituted or be liable to be viewed as determinative of FMV.

10. According to Mr. Vohra, the question which stands posited for our consideration is no longer res integra and stands duly settled by virtue of the judgment of the Karnataka High Court in **Commissioner of Income Tax v. Infosys Technologies Ltd.**[7] and which ultimately came to be affirmed by the Supreme Court in **Commissioner of Income Tax, Bangalore v. Infosys Technologies Ltd**[8]. We note that the Supreme Court, while affirming the view expressed by the Karnataka High Court had observed as follows:-

> "**11.** Warrant is a right without obligation to buy. Therefore, perquisite cannot be said to accrue at the time when warrants were granted in this case. Same would be the position when options vested in the employees after lapse of 12 months. It is important to note that in this case options were exercisable only after the cooling period of 12 months. Further, it was open to the employees not to avail of the benefit of option. It was open to the employees to resign. There was no certainty that the option would be exercised. Further, the shares were not transferable for 5 years (lock-in period). If an employee

---

[7](2007)159 Taxman 440

[8](2008) 2 SCC 272

resigned during the lock-in period the shares had to be retransferred. During the lock-in period, the possession of the shares, which is an important ingredient of shares, remained with the Trust. The Stock Exchange was duly notified about non-transferability of the shares during the lock-in period. The shares were stamped with the remark non-transferable during the lock-in period. It was not open to the employees to hypothecate or pledge the said shares during the lock-in period. During the said period, the said shares have no realisable value, hence, there was no cash in flow to the employees on account of mere exercise of options. On the date when the options were exercised, it was not possible for the employees to foresee the future market value of the shares. Therefore, in our view, the benefit, if any, which arose on the date when the option stood exercised was only a notional benefit whose value was unascertainable. Therefore, in our view, the Department had erred in treating Rs. 165 crores as perquisite value being the difference in the market value of shares onthe date of exercise of option and the total amount paid by the employees consequent upon exercise of the said options.

xxxx **xxxx** **xxxx**

14. As stated above, unless a benefit/receipt is made taxable, it cannot be regarded as 'income'. This is an important principle of taxation under the 1961 Act. Applying the above principle to the insertion of clause (iiia) in Section 17(2) one finds that for the first time w.e.f. 1.4.2000 the word 'cost' stood explained to mean the amount actually paid for acquiring specified securities and where no money had been paid, the cost was required to be taken as nil.

15. In the case of Commissioner of Income-Tax, Bangalore v. B.C. Srinivasa Setty [(1981) 128 ITR 294 (SC)] this Court held that the charging section and computation provision under the 1961 Act constituted an integrated code. The mechanism introduced for the first time under the Finance Act, 1999 by which 'cost' was explained in the manner stated above was not there prior to 1.4.2000. The new mechanism stood introduced w.e.f. 1.4.2000 only. With the above definition of the word 'cost' introduced vide clause (iiia), the value of option became ascertainable. There is nothing in the Memorandum to the Finance Act, 1999 to say that this new mechanism would operate retrospectively. Further, a mechanism which explains 'cost'in the manner indicated above cannot be read retrospectively unless the Legislature expressly says so. It was not capable of being implemented retrospectively. Till 1.4.2000, in the absence of the definition of the word 'cost',value of the option was not ascertainable. In our view, clause (iiia) is not clarificatory. Moreover, the meaning of the words 'specified securities' in section (iiia) was defined or explained for the first time vide Finance Act,

1999 w.e.f. 1.4.2000. Moreover, the words allotted or transferred in clause (iiia) made things clear only after 1.4.2000. Lastly, it may be pointed out that even clause (iiia) has been subsequently deleted w.e.f. 1.4.2001. For the aforestated reasons, we are of the view the clause (iiia) cannot be read as retrospective.

16. Be that as it may, proceeding on the basis that there was 'benefit', the question is whether every benefit received by the person is taxable as income? In our view, it is not so. Unless the benefit is made taxable, it cannot be regarded as income. During the relevant assessment years, there was no provision in law which made such benefit taxable as income. Further, as stated, the benefit was prospective. Unless a benefit is in the nature of income or specifically included by the Legislature as part of income, the same is not taxable.In this case, the shares could not be obtained by the employees till the lock-in period was over. On facts, we hold that in the absence of legislative mandate a potential benefit could not be considered as 'income' of the employee(s) chargeable under the head'salaries'. The stock was non-transferable and the stock exchange was also accordingly notified. This is where the weightage ought to have been given by the AO to an important factor, namely, lock in period. This has not been done. It is important to bear in mind that if the shares allotted to the employee had no realizable sale value on the day when he exercised his option then there was no cash inflow to the employee. It was not possible for the employee to know the future value of the shares allotted to him on the day he exercises his option. Even the cost of acquisition as 'nil' came to be introduced in the 1961 Act by the Finance Act, 1999 only with effect from 1.4.2000. In fact, the later deletion of clause (iiia) is an indicator of the Ineffective Charge.

17. For the aforestated reasons, we are of the view that the Department had erred in treating Rs. 165 crores as a perquisite value for the assessment years 1997-98, 1998-99 and 1999- 2000. During those years, the fifth anniversary had not taken place and, therefore, it was not possible for the assessee company to estimate the value of the perquisite during that period. It was not open to the Department to ignore the lock in period. Therefore, the Department had erred in treating the respondent herein as an assessee in default for not deducting the TDS at 30% as stated in the order of assessment. This is not the case of tax evasion. The assessee had floated the Trust because of the buy back problems, which were genuine problems in cases where the employees stood dismissed, removed or in the case of resignation in which cases they were required to return the allotment."

11. The decision in *Infosys Technologies* assumes added significance since the allotted shares which formed subject matter of those proceedings were also subject to a lock-in restriction. The Supreme Court took note of the fact that undisputedly during the lock-in period, the custody of the shares remained with the Trust and the shares themselves were non-transferable. It was while dealing with the aforesaid controversy that the Supreme Court was called upon to examine whether the AO was justified in taking the market value of the shares into consideration. The significance of the lock-in period was explained by the Supreme Court to mean that during the said period the share would have no realizable value nor would it be possible for the employee to foresee or project a price which those shares may obtain in the future. It was thus pertinently observed that a potential benefit could not be considered as income of the employee and which may be chargeable under the broad head of salaries.

12. The aforesaid aspect and the broad principles which came to be propounded in *Infosys Technologies* find resonance in a subsequent decision handed down by that Court in **Deputy Commissioner of Gift-Tax v. BPL Ltd.**[9]. In *BPL Ltd.,* the Supreme Court was concerned with promoter quota shares and which too were subject to a lock-in restriction. Those promoter quota shares had come to be gifted by M/s BPL Limited to M/s Celestial Finance Limited. The question which arose for consideration was the value liable to be attributed to that gift in terms of the provisions made in the **Gift Tax Act, 1958**[10].

---

[9] (2022) 448 ITR 739
[10] 1958 Act

13. It becomes pertinent to note that for the purposes of valuation of properties under the aforesaid enactment, the statute bids one to adopt the provisions enshrined in Schedule III of the Wealth Tax Act, 1957. Rule 9 as appearing in Schedule III of the latter enactment read as follows:-

> "(9) "quoted share" or "quoted debenture", in relation to an equity share or a preference share or, as the case may be, a debenture, means a share or debenture quoted on any recognised stock exchange with regularity from time to time, where the quotations of such shares or debentures are based on current transactions made in the ordinary course of business. Explanation.—Where any question arises whether a share or debenture is a "quoted share" or a "quoted debenture" within the meaning of this clause, a certificate to that effect furnished by the concerned stock exchange in the prescribed form shall be accepted as conclusive;"

14. The question which stood raised ultimately came to be answered by the Supreme Court in the following terms:-

> "**5.** We are in agreement with the view expressed in the impugned judgment, which observes that the equity shares under the lock-in period were not "quoted shares", for the simple reason that the shares in the lock-in period were not quoted in any recognised stock exchange with regularity from time to time. There are no current transactions relating to these shares made in the ordinary course of business. These equity shares being under the lock-in period could not be traded and, therefore, remained unquoted in any recognised stock exchange. There, therefore, would be no current transactions in respect of these shares made in the ordinary course of business.
>
> **6.** When the equity shares are in a lock-in period, then as per the guidelines issued by the Securities and Exchange Board of India (SEBI), there is a complete bar on transfer, which is enforced by inscribing the words "not transferable" in the relevant share certificates. This position is accepted by the Revenue, which, however, has relied upon a general circular issued by the Securities and Exchange Board of India, wherein it is stated that the shares under the lock-in period can be transferred inter se the promoters. This restricted transfer, in our opinion, would not make the equity shares in the lock-in period into "quoted shares" as defined vide sub-rule (9) to rule 2 of Part A of Schedule III of the Wealth-tax Act, as

the lock-in shares are not quoted in any recognised stock exchange with regularity from time to time, and it is not possible to have quotations based upon current transactions made in the ordinary course of business. Possibility of transfer to promoters by private transfer/sale does not satisfy the conditions to be satisfied to regard the shares as quoted shares.

xxxx **xxxx** **xxxx**

8. Equity shares which are quoted and transferable in the stock exchange are to be valued on the basis of the current transactions and quotations in the open market. The market quotations would reflect the market value of the equity shares that are transferable in a stock exchange, but this market price would not reflect the true and correct market price of shares suffering restrictions and bar on their transferability. The shares in question would become transferable post the lock-in period. It is a fact that the market price fluctuates, and the share prices can move up and down. Share prices do not remain static. Equally, the restriction or bar on transferability has an effect on the value/price of the shares. Easy and unrestricted marketability are important considerations that would normally impact valuation/price of a share. Therefore, one may have to depreciate the value of the lock-in equity shares, viz., shares that are free from such restriction.

9. In terms of the rules, we cannot apply a hybrid method of valuation while applying rule 9 of Part C of Schedule III of the Wealth- tax Act, which prescribes the method of valuation for quoted shares. Ad hoc depreciation/ reduction from the quoted price of equity shares transferable in the open market is not permitted and allowed vide rule 9 of Part C of Schedule III of the Wealth-tax Act. The shares in question being "unquoted shares", therefore, have to be valued in terms of rule 11 as a standalone valuation method. This would be in accord with sub-section (1) to section 6 of the Gift-tax Act, which states that the value of a property, other than cash, transferred by way of gift, shall be valued on the date on which the gift was made and shall be determined in the manner as laid down in Schedule II of the Gift-tax Act, which, as noticed above, makes the provisions of Schedule III of the Wealth-tax Act, applicable.

10. Faced with the aforesaid position, the Revenue has relied upon rule 21 of Part H of Schedule III of the Wealth-tax Act, which reads thus:

> "21. Restrictive covenants to be ignored in determining market value. For, the removal of doubts, it is hereby declared that the price or other consideration for which any property may be acquired by or transferred to any person under the terms of a deed of trust or through or under any

> restrictive covenant in any instrument of transfer shall be ignored for the purposes of determining under any provision of this Schedule, the price such property would fetch if sold in the open market on the valuation date."
>
> In order to understand the import of rule 21 of Part H of Schedule III of the Wealth-tax Act, it is necessary to refer to earlier judgments of this court on the valuation of equity shares or property not freely transferable or where transfer is restricted. Reference to these decisions is also relevant as it supports our interpretation in highlighting the difference between "quoted" and "unquoted" shares.

11. In Ahmed G. H. Ariff v. CWT, a three judge Bench of this court, in a matter relating to the Wealth-tax Act, for a period when Schedule III of the Wealth-tax Act, was not applicable, had observed that the expression "property" is a term of the widest import as it signifies every possible interest which a person can clearly hold or enjoy. "Property", as a term, should be given a liberal and wide connotation, and extends to those well-recognised types of interests that have the insignia or characteristics of apropprietary right. Having held so, this court rejected the argument ofthe assessee therein that his right to receive a specified share of thenet income from an estate in respect of a Wakf-Alal-Aulad was not an asset assessable to wealth-tax, on the ground that this asset had "nilor no value as it was of a non-transferable nature. It was held thatwealth-tax under section 3 of the Wealth-tax Act, is imposed on thecharge of net wealth, which necessarily includes in it every descriptionof property of the assessee, movable or immovable, barring theexceptions as stated in the provisions of the Wealth-tax Act. <u>Moresignificant for our purposes are the observations that the words "if soldin the open market" does not contemplate actual sale or the actualstate in the market, but only enjoins that it should be assumed thatthere is an open market and the property, even with the restrictions,can be sold in such a market, and on that basis the value has to befound out</u>. <u>Therefore, the expression "if sold in the open market" refersto a hypothetical case, where, for the purpose of valuation, one mustassume that there is an open market in which an asset with restrictionsor bar on transfer can be sold.</u> This decision was followed in PurshottamN. Amarsay v. CWT, which was a case relating to the valuation of theright to property of the assessee in a trust. The argument of theassessee that the right to property in a trust, being a personal estate, isincapable of being sold in the open market and, therefore, it wouldhave "nil" or no value was rejected. This decision in this context quotesAhmed G. H. Ariff (supra). At this stage, it would be relevant to refer tothe decision of the House of Lords in Commissioners of Inland Revenuev. Crossman which decision was referred to with approval in both Ahmed G.H. Ariff (supra) and

Purshottam N. Amarsay (supra). Themajority decision of the House of Lords in Crossman's case (supra), acase relating to estate duty, holds that where the right to transfershares of a limited company is restricted and while its value is not "nil"or "0", it should be valued on the basis and accounting for therestriction.

The contention that in view of the bar on transfer no property was actually passed on death, and a fresh set of rights in favour of the legatees came into existence was disapproved. At the same time, it was held that the shares cannot be valued ignoring the restrictions on transfer, as contained in the articles of association in that case, as that would be to value the property which the deceased as an owner did not own. Even if the shares were not transferable in the open market in terms of the articles of association, the shares had certain privileges and rights, which form the ingredients in its value. The expression "if sold in the open market" does not alter the nature of the property. What the expression postulates is to permit the assessee or the authorities to assume a sale in the open market, which is to limit the property to be valued at the price that a person would beprepared to pay in the open market with all rights and obligations. The value would not exceed the sum, which a willing purchaser would pay, given the fact that the right to purchase is restricted or barred. This does not imply that the valuation of the shares can be made artificially and by ignoring the restrictions on the property. Valuation cannot ignore the limitations attached to the shares. This judgment in Crossman's case (supra) has been subsequently reiterated by the House of Lords in Lynall v. Inland Revenue Commissioners. Referring to the decision in Crossman's case (supra) and a decision of the High Court of Australia in Abrahams v. Federal Commissioner of Taxation, a Division Bench of the Madras High Court in R. Rathinasabapathy Chettiar v. CWT, in our opinion, has rightly observed:

> "13. In Abraham v. Federal Commissioner of Taxation at the time of his death a deceased owned shares in five companies, four of which carried on investment business, and the fifth a pastoral business. The brother of the deceased who held equal interest in the whole of the issued capital of the companies was appointed the sole executor. The memorandum and articles of association of the four companies contained a restriction on transfer of shares whereby the board of directors may refuse to register any transfer of shares to a transferee who was in their opinion an undesirable person to be admitted as a member of the company. In the fifth company the articles of association provided that the

> governing directors should have a right at any time of purchasing the shares of all the-members of the company, the purchase price to be the amount paid up thereon or, at the option of the governing directors, the amount which bore the same proportion to the excess value of the assetsover the liabilities of the company as the total amount paid up onthe shares bore to the total paid up capital of the company. The question arose as to how the shares left by the deceased are to be valued for the purpose of estate duty. The court held that the assessment of value of the shares held by the deceased in the five companies must normally be made principally on the basis of the income yield including the strong probability of distribution of accumulated profits and that the effect ofthe restrictions on transfer of shares and the right of pre-emption given to the governing directors to purchase the shares must all be taken note of and depreciation on that account had to be allowed for in the primary valuation. The above case laid down the principle that the restrictions contained in the articles of association on the transfer and also on the price for which the shares could be transferred has to be ignored and the transferability in the open market must be assumed, for the purpose of valuation, but that the market value of the shares has to be depreciated to a certain extent having regard to the said restrictions contained in the articles of association, and that if the market value of such shares could not be ascertained otherwise, it is possible to value the shares on a break-up basis with reference to the balance-sheet of the company for the relevant year."

xxxx xxxx xxxx

15. Read in this manner, rule 21 of Part H of Schedule III of the Wealth-tax Act, is a rule which has been enacted to clarify and remove doubts. It has reiterated and affirmed the dictum in Ahmed G. H. Ariff (supra) and Purshottam N. Amarsay (supra) that notwithstanding the negative covenants prohibiting or restricting transfer, the property should be valued for the purpose of the Wealth-tax Act, and the Gift- tax Act, but the valuation is not by overlooking or ignoring the restrictive conditions. The shares in the lock-in period have market value, which would be the value that they would fetch if sold in the open market. Rule 21 of Part H of Schedule III of the Wealth-tax Act, permits valuation of the property even when the right to transfer the property is forbidden, restricted or contingent. Rights and limitations attached to the property form the ingredients

in its value. The purpose is to assume that the property which is being valued is being sold, and not to ignore the limitations for the purpose of valuation. This is clear from the wording of rule 21 of Part H of Schedule III of the Wealth-tax Act, which when read carefully expresses the legislative intent by using the words "hereby declared". The rule declares that the price or other consideration for which any property may be acquired by, or transferred, to any person under the terms of a deed of trust or through any other restrictive covenant, in any instrument of transfer, is to be ignored as per theprovisions of the Schedule III of the Wealth-tax Act. However, the price of such property is the price of the property with the restrictions if sold in the open market on the valuation date. In other words, notwithstanding the restrictions, hypothetically the property would be assumed to be saleable, but the valuation as per the Schedule III of the Wealth-tax Act, would be made accounting and taking the limitation and restrictions, and such valuation would be treated as the market value. The rules do not postulate a charge in the nature and character of the property. Therefore, the property has to be valued as per the restrictions and not by ignoring them."

15. We also bear in mind the well-settled position in law of the Act not contemplating a tax being levied on notional income. We deem it apposite to extract the following passages from the decision of the Supreme Court in **Commissioner of Income Tax v. Excel Industries Ltd**[11]:

> "**24.** This Court did not accept the view taken by the High Court on facts. Reference was made in this context to Commissioner of Income Tax v. Birla Gwalior (P.) Ltd., [1973] 89 ITR 266 (SC) wherein it was held, after referring to Morvi Industries that real accrual of income and not a hypothetical accrual of income ought to be taken into consideration. For a similar conclusion, reference was made to Poona Electric Supply Co. Ltd. v. Commissioner of Income Tax, [1965] 57 ITR 521 (SC) wherein it was held that income tax is a tax on real income.
>
> **25**. Finally a reference was made to State Bank of Travancore v. Commissioner of Income Tax, [1986] 158 ITR 102 (SC) wherein the majority view was that accrual of income must be real, taking into account the actuality of the situation; whether the accrual had taken

[11](2014) 13 SCC 459

place or not must, in appropriate cases, be judged on the principles of real income theory. The majority opinion went on to say:

> "What has really accrued to the assessee has to be found out and what has accrued must be considered from the point of view of real income taking the probability or improbability of realisation in a realistic manner and dovetailing of these factors together but once the accrual takes place, on the conduct of the parties subsequent to the year of closing an income which has accrued cannot be made "no income".

26. This Court then considered the facts of the case and came to the conclusion (in Godhra Electricity) that no real income had accrued to the assessee in respect of the enhanced charges for a variety of reasons. One of the reasons so considered was a letter addressed by the Under Secretary to the Government of Gujarat, to the assessee whereby the assessee was "advised" to maintain status quo in respect of enhanced charges for at least six months. This Court took the view that though the letter had no legal binding effect but "one has to look at things from a practical point of view." (See R.B. Jodha Mal Kuthiala v. Commissioner of Income Tax, [1971] 82 ITR 570 (SC)). This Court took the view that the probability or improbability of realisation has to be considered in a realistic manner and it was held that there was no real accrual of income to the assessee in respect of the disputed enhanced charges for supply of electricity. The decision of the High Court was, accordingly, set aside.

27. Applying the three tests laid down by various decisions of this Court, namely, whether the income accrued to the assessee is real or hypothetical; whether there is a corresponding liability of the other party to pass on the benefits of duty free import to the assessee even without any imports having been made; and the probability or improbability of realisation of the benefits by the assessee considered from a realistic and practical point of view (the assessee may not have made imports), it is quite clear that in fact no real income but only hypothetical income had accrued to the assessee and Section 28(iv) of the Act would be inapplicable to the facts and circumstances of the case. Essentially, the Assessing Officer is required to be pragmatic and not pedantic."

16. In our considered opinion, in light of the restriction with respect to marketability and tradeability of the stock in question, the FMV could not have been recognized to exceed the face value of the shares and

thus the determinative being INR 15/-. The Valuation Report, as noted above, was at best a medium adopted by the employer in order to broadly ascertain its obligations for the purposes of withholding tax. The same could not have consequently been taken into consideration for the purposes of FMV. The position which was advocated by the respondents, namely, for the quoted price or the Valuation Report being taken into consideration is clearly untenable, since the same could have had no application to a share which was subject to a lock-in stipulation and could not be sold in the open market owing to a complete embargo on the sale of those shares.

17. We accordingly answer Question 1 posited in the affirmative and in favour of the assessee. Question 2 is answered in the negative and it being held that the face value alone would be conclusive for purposes of taxation.

18. Accordingly, while ITA 281/2008 shall stand allowed, the appeal of the Commissioner being ITA 770/2008 shall stand dismissed. The order of the Tribunal dated 27 April 2007 is hereby set aside.

YASHWANT VARMA, J.

RAVINDER DUDEJA, J.

AUGUST, 14 2024/RW