Workmen Employed In Associated Rubber ... vs Associated Rubber Industry Ltd., ... on 19 August, 1985

Equivalent citations: AIR1986SC1, [1985(51)FLR478], [1986]157ITR77(SC), (1986)ILLJ142SC, 1985(2)SCALE321, (1985)4SCC114, 1986(1)SLJ218(SC), 1986(1)UJ235(SC), AIR 1986 SUPREME COURT 1, 1986 LAB. I. C. 37, 1986 UJ (SC) 235, 1985 (19) TAX LAW REV 308, 1986 TAXATION 80 (2) 34, (1985) 67 FJR 196, 1985 (4) SCC 114, (1986) 1 SERVLJ 218, (1985) 48 CURTAXREP 355, (1986) 1 CURLR 284, (1985) 51 FACLR 478, (1986) 157 ITR 77, (1986) 1 LABLJ 142, (1985) 2 LAB LN 848, (1986) 1 SCWR 17, (1986) 59 COMCAS 134

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Bench: O. Chinnappa Reddy, V. Khalid

JUDGMENT

O. Chinnappa Reddy, J.

1. The Workmen of The Associated Rubber Industry Ltd., Bhavnagar are the appellants in this appeal filed pursuant to a certificate under Article 133(1) of the Constitution granted by the High Court of Gujarat.

2. The Associated Rubber Industry Ltd. had purchased, some years back, shares of INARCO Ltd. by investing a sum of Rs. 4,50,000/-. They were getting annual dividends in respect of these shares and the amount so received was shown in the Profit and Loss Account of the company year after year. It was taken into account for the purpose of calculating the bonus payable to the workmen of the company. Some time in the course of the year 1968, the company transferred the shares of INARCO Ltd. held by it to Aril Bhavnagar Ltd. (subsequently changed to the Aril Holdings Ltd.), a subsidiary company wholly owned by The Associated Rubber Industry Ltd. Aril Holdings Ltd. "had no other capital except the shares of INARCO Ltd. transferred to it by the Associated Rubber Industry Ltd. It had no other business or source of income whatsoever except receiving the dividend on the shares of INARCO Ltd. The dividend income from the shares of INARCO Ltd. was not transferred to The Associated Rubber Industry Ltd. and therefore, it did not find place in profit and Loss Account of the company with the result that the available surplus for the purposes of payment of bonus to the workmen of the company became reduced. The net result of the exercise was that bonus at the rate of 4% only was paid to the workers for the year 1969 instead of at the rate of 16% to which they would have otherwise been entitled. We may mention here that Aril Holdings Ltd. was itself wound up in the year 1971 and amalgamated with The Associated Rubber Industry Ltd.

3. The workmen of the Associated Rubber Industry Ltd., Bhavnagar raised an industrial dispute claiming that they were entitled to be paid bonus at the rate of 16% for the year 1969. According to them, the transfer of the shares of INARCO Ltd. to Aril Holdings Ltd. was no more than a device to avoid payment of higher bonus to the workmen. Industrial Tribunal and thereafter the High Court of Gujarat under Article 226 of the Constitution, held that The Associated Rubber Industry Ltd. and Aril Holdings Ltd. were two independent companies with separate legal existence and therefore, the profits made by Aril Holdings Ltd. could not be treated as profits of The Associated Rubber Industry Ltd. for the purpose of computing to gross profits earned by the Associated Rubber Industry Ltd. It was further held that there was no evidence to show that the transfer of shares to Aril Holdings Ltd. was only a device to avoid payment of bonus to the workmen.

4. It is true that in law The Associated Rubber Industry Ltd. and Aril Holdings Ltd. were distinct legal entities having separate existence. But, in our view, that was not an end of the matter. It is the duty of the court, in every case where ingenuity is expended to avoid taxing and welfare legislations, to get behind the smoke-screen and discover the true state of affairs. The court is not to be satisfied with form and leave well alone the substance of a transaction. In The Commissioner of Income-Tax, Madras v. Sri Meenakshi Mills Ltd. and Ors. , the judicial approach to such problems was stated as follows :

> It is true that from the juristic point of view the company is a legal personality entirely distinct from its members and the company is capable of enjoying rights and being subjected to duties which are not the same as those enjoyed or borne by its members. But in certain exceptional cases the Court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal facade. For example, the Court has power to disregard the corporate entity if it is used for tax evasion or to circumvent tax obligation. For instance, in Apthorpe v. Peter Schoenhofen Brewing Co. 4 T.C. 41 the Income lax Commissioners had found as a fact that all the property of the New York company, except its land, had been transferred to an English company, and that the New York company had only been kept in being to hold the land, since aliens were not allowed to do so under New York law. All but three of the New York Company's shares were held by the English company, and as the Commissioner also found, if the business was technically that on the New York company, the latter was merely the agent of the English company. In the light of these findings the Court of Appeal, despite the argument based on Salomon's case. (1897) A.C. 22 held that the New York business was that of the English company which was liable for English income tax accordingly. In another case-Fire stone Tyre and Rubber Co. v. Llewellin (1957) 1 W.L.R. 464. an American company had an arrangement with its distributors on the Continent of Europe whereby they obtained supplies from the English manufacturers, its wholly owned subsidiary. The English company credited the American with the price received after deducting the costs plus 5 per cent. It was conceded that the subsidiary was a separate legal entity and not a mere emanation of the American parent, and that it was selling its own goods as principal and not its parent's goods as agent. Nevertheless, these sales were a means whereby the American company carried on its

> European business, and it was held that the substance of the arrangement was that the American company traded in England through the agency of its subsidiary. We therefore, reject the argument of Mr. Venkataraman on this aspect of the case.
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> More recently we have pointed out in Mc Dowell and Company Limited v. Commercial Tax Officer (1985) 3 SCC 230 :
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> It is up to the Court to take stock to determine the nature of the new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices could be related to the existing legislation with the aid of 'emerging techniques of interpretation as was done in Ramsay, Burmah Oil and Dawson, to expose the devises for what they really are and to refuse to give judicial benediction.
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> In that case, the court also had occasion to refer to the following observations of Lord Brightman in Furniss v. Dawson (1984) 1 All ER 530 :
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> The fact that the court accepted that each step in a transaction was a genuine step producing its intended legal result did not confine the court to considering each step in isolation for the purpose of of assessing the fiscal results.
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> Avoidance of welfare legislation is as common as avoidance of taxation and the approach in considering problems arising out of such avoidance has necessarily to be the same.

5. If we now look at the facts of the case, what do we find.? A new company is created wholly owned by the principal company, with no assets of its own except those transferred to it by the principal company, with no business or income of its own except receiving dividends from shares transferred to it by the principal company and serving no purpose whatsoever except to reduce the gross profits of the principal company. These facts speak for themselves. There cannot be direct evidence that the second company was formed as a device to reduce the gross profits of the Principal company for whatever purpose. An obvious purpose that is served and which stares one in the face is to reduce the amount to be paid by way of bonus to workmen. It is such an obvious device that no further evidence, direct or circumstantial, is necessary. It was argued that in 1971, the Aril. Holdings Ltd. was wound up and amalgamated with The Associated Rubber Industry Ltd. and that this circumstance showed that the initial creation of Aril Holdings Ltd. was not a device of avoidance. But the learned counsel for the company was unable to explain why in the first instance Aril Holdings Ltd. was created and why later it was wound up. Probably, after Aril Holdings Ltd. was created, some unforseen difficulties arose which have not been brought to light before us and it became necessary to wind it up amalgamate it with The Associated Rubber Industry Ltd. We are therefore, satisfied that the amount of dividend from INARCO Ltd. received by the Aril Holdings Ltd. should be taken into account in assessing the gross profit of The Associated Rubber Industry Ltd. for the purpose of calculating the rate of bonus payable to the workmen of the Associated Rubber Industry Ltd. The appeal is allowed with costs and it is declared that workmen of The Associated Rubber Industry Ltd. Bhavnagar are entitled to be paid bonus at the rate of 16% for the

year 1969.