Raghuvanshi Mills, Ltd vs Commissioner Of Income-Tax, Bombay on 7 December, 1960

Equivalent citations: 1961 AIR 743, 1961 SCR (2) 978, AIR 1961 SUPREME COURT 743

Author: M. Hidayatullah

Bench: M. Hidayatullah, J.L. Kapur, J.C. Shah

PETITIONER:
RAGHUVANSHI MILLS, LTD.

Vs.

RESPONDENT:
COMMISSIONER OF INCOME-TAX, BOMBAY

DATE OF JUDGMENT:
07/12/1960

BENCH:
HIDAYATULLAH, M.
BENCH:
HIDAYATULLAH, M.
KAPUR, J.L.
SHAH, J.C.

CITATION:
1961 AIR 743 1961 SCR (2) 978
CITATOR INFO :
F 1961 SC1154 (6,8)
R 1967 SC 768 (13)
RF 1976 SC1141 (3,13)

ACT:
Income Tax--Majority shares of the assessee company held by Directors and their relations, if can be treated as held by the Public--Test--Indian Income-tax Act, 1922 (11 of 1922), S. 23A, Third Proviso, Explanation (before amendment by the Finance Act, 1955).

HEADNOTE:
One Maganlal Parbhudas who was a Director of the assessee company held 6,344 shares out of a total of 10,000 shares of the company and he made a gift of 1000 shares to each of his

five sons. During the accounting period the company had eight Directors including the said Maganlal Parbhudas and two of his sons and they held 4695 shares as between themselves. Out of the balance of the shares 4754 shares were held by the relatives of some of the Directors. Three sons of Maganlal Parbhudas were Directors of the Managing Company. The Income-tax Officer applied s. 23A of the Income-tax Act as it stood prior to its amendment by the Finance Act, 1955 to the company holding that this was not a company in which the public were substantially interested. The order of the Income Tax Officer was confirmed on appeal both by the Assistant Commissioner and the Tribunal. The High Court remitted the case to the Tribunal for a statement whether the Directors were exercising de facto control over any of the other shareholders. The Tribunal thereupon gave the finding that the Directors, particularly the three sons of Maganlal Parbhudas who formed the Directors of the Managing Company were under the de facto control of their father. The High Court agreed with the finding of the tribunal and held that on the facts and circumstances of the case the shares held by the three sons of Maganlal Parbhudas could not be considered to be shares held by the members of the public within the meaning of the Explanation to the third proviso to S. 23A of the Income Tax Act. On appeal by the assessee company,

Held, that in the Explanation the word "public" is used in contradistinction to one or more persons who act in unison and among whom the voting power constitutes a block. If such a block exists and possesses more than seventy five per cent of the voting power, then the company cannot be said to be one in which the public are substantially interested.

Sardar Baldev Singh v. Commissioner of Income-tax, Delhi and Ajmer, [1961] 1 S.C.R. 482, considered.

The test is first to find out whether there is an individual or a group which controls the voting power as a block. If there is such a block the shares held by it cannot be said to be held

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"unconditionally" or "beneficially" by the public. Only those shares which are "unconditionally" and "beneficially" held by the public uncontrolled by the controlling group can be treated as shares held by the public under the Explanation. The group may be composed of Directors or their nominees or relations in different combinations, but none can be said to belong to that c group, be he a Director or a relative unless he does not hold the shares unconditionally and beneficially for himself. It is only such a person who can fall properly outside the word "public".

The view that Directors merely by reason of their being Directors stand outside the "public" is erroneous.

Commissioner of Income-tax v. H. Bjordal, [1955] A. C. 309, followed.

Mere relationship is of no consequence unless it is proved that the voting power of one relative is controlled by another relative.
Tatem Steam Navigation Co. v. Commissioner of Inland Revenue, (1941) 24 T.C. 56, followed.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 30 of 1957. Appeal by special leave from the judgment and order dated September 1, 1955, of the Bombay High Court in Income-tax Reference No. 37 of 1952.

N. A. Palkhivala and I. N. Shroff, for the appellant. K. N. Rajagopala Ayyangar and D. Gupta, for the respondent.

1960. December 7. The Judgment of the Court was delivered by HIDAYATULLAH, J.-The Raghuvanshi Mills Ltd., Bombay (a public limited Company), has filed this appeal by special leave against the judgment and orders of.the High Court of Bombay dated March 10, 1953, and September 1, 1955. By the first order, the Bombay High Court directed the Income-tax Tribunal to submit a supplementary statement in the case in the light of its judgment, giving the parties liberty to lead further evidence, if any. By the second order, the High Court re-framed the question, and answered it against the assessee.

The assessee Company's issued and subscribed capital was, at the material time, Rs. 10,00,000 divided into 10,000 shares of Rs. 100 each. Prior to November 14, 1941, one Maganlal Parbhudas, who was a Director of the Company, held 6,344 shares. On November 14, 1941, he made a gift of 1,000 shares to each of his five sons, Ravindra, Surendra, Bipinchandra, Hareshchandra and Krishnakumar. We are concerned with the account year of the Company, April 1, 1942, to March 31, 1943, the assessment year being 1943-44. In that year, the dividend which was declared at the Annual General Meeting held on December 17, 1943, was less than what was required under s. 23A of the Indian Income-tax Act. The question, therefore, arose whether the Company could be said to be one to which s. 23A(1) of the Act was applicable, regard being had to the third proviso and the Explanation under it. During the accounting period, the Company had eight Directors, whose names along with the shares respectively held by them are given below:

Shares (1) Shri Maganlal Parbhudas 1,344 (2) Ravindra Maganlal 1,168 (3) Surendra Maganlal... 1,100 (4) Amritlal Chunilal (jointly with Babulal Chunilal)... 833 (5) Babulal Chunilal.... 100 (6) Bhagwandas Harakchand.... 50 (7) Haridas Purshottam.. 50 (8) Sir Chunilal B. Mehta (jointly with Lady Tapibai Chunilal) 50

Total 4,695

Out of the balance of the shares, 4,754 shares were held by the relatives of some of the above-named Directors, as stated below:

> Shares (1) Shrimati Kantabai Maganlal (wife of a Director) 771 (2) Shri Bipinchandra Maganlal 1,000 (3) Shri Hareshchandra Maganlal (son of a Director) 1,000 (4) Shri Krishnakumar Maganlal (do) 1,000 (5) Shrimati Dhanlaxmi Mohanlal (6) Srimati Prabhavati Nanalal Harilal (5 and 6 daughters of a Director) 50 (7) Shri Hirjibhai Purshottam and Haridas Purshottam (brothers of a Director) 25 (8) Shri Dhanjibhai Purshottam and Haridas Purshottam (brothers (9) Shri Chimanlal Vithaldas (cousin of a Director) 833
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Total 4,754

The remaining 551 shares were held by the members of the public, who were not connected with the Directors of the Company in any way.

Before March, 1942, Messrs. Ravindra Maganlal and Bros. were the Managing Agents of the Company. Maganlal Parbhudas was the sole proprietor of that firm. On March 7, 1942, the Company appointed Ravindra Maganlal & Co. Ltd. as the Managing Agents for. a period of 20 years. The Managing Company had a total issued and subscribed capital of Rs. 5,000 and the five sons of Maganlal Parbhudas who have been named before had subscribed that capital equally. During the account year, Maganlal Parbhudas and two of his sons, Ravindra Maganlal and Surendra Maganlal, were three of the Directors of the Company. Ravindra, Surendra and Bipinchandra were Directors of the Managing Company. On these facts, the Income-tax Officer applied s. 23A (as it stood prior to its amendment by the Finance Act, 1955) to the Company, holding that this was not a Company in which the public were substantially interested. The order of the Income-tax Officer was confirmed on appeal, both by the Appellate Assistant Commissioner and the Tribunal. The Tribunal also refused to state a case under s. 66(1) of the Incometax Act, but the High Court of Bombay acting under s. 66(2) called for a statement of the case on the question:

> "Whether on the facts and circumstances of the case the provisions of s. 23A of the Indian Income-tax Act (XI of 1922) are applicable to the petitioners?" In stating the cases the Tribunal pointed out that probably the question ought to have been:
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> "Whether on the facts and circumstances of the case 1,000 shares each held by Bipinchandra, Haresh chandra and Krishnakumar in the capital of the assessee Company are held by members of the public within the meaning of the Explanation to the third proviso to s. 23A?"

The members of the Tribunal in deciding the appeal before them, gave slightly different reasons. According to the Accountant Member, the shares held by persons interested in the Managing Company were under the control of the Directors of the appellant Company, and those persons could not be considered to be members of the public. The Judicial Member held that the Directors were controlling the shareholders of the Company, that their relatives were mere nominees, whose voting power was controlled by the Directors, and that the public could not, therefore, be said to be substantially interested, as required by the Explanation to the third proviso to the section.

When the High Court heard the case, the learned Judges addressed themselves to the question, what was the proper meaning of the expression "held by the public" in the Explanation. They came to the conclusion that the object of the third proviso and the Explanation was that the voting power to be exercised by the public should be independent of the control of the Directors, and that the word "Public" was used in contradistinction to the Directors. They apparently thought that a holding by a Director could not be described, in any event, as a holding by the public. The High Court came to the tentative opinion that both the tests stated by the Accountant Member and the Judicial Member were incorrect, and held that what the law required was de facto control, 4 c a control which is, in fact, exercised," and that no finding appeared to have been given on that point by the Tribunal. The case was accordingly remitted to the Tribunal for submission of a fresh statement of the case whether the Directors were exercising de facto control. over any of the other shareholders, who belonged to the second category mentioned by us above. The Tribunal thereupon re- stated the case, and after examining further evidence, gave the finding that the Directors, particularly the three sons of Maganlal Parbhudas who formed the Directors of the Managing Company were under the de facto control of their father. At no stage in the case did the Tribunal alter the finding reached by the Department that the shares of the Company were not, in fact, freely transferable by the holders to members of the public.

The High Court then reheard the case, and came to the conclusion that there was evidence on which the Tribunal could hold that Maganlal Parbhudas exercised de facto control over his three sons. In view of this finding, the High Court held that the order made by the Tribunal was correct, and answered the question in the negative, re- framing it as follows:

> "Whether on the facts and circumstances of the case the shares held by Bipinchandra, Harishchandra and Krishnakumar can be considered to be shares held by members of the public within the meaning of the explanation to the third proviso to Section 23A?" The High Court refused to grant a certificate; but the Company has obtained special leave from this Court, and has filed this appeal. It is first contended that the test that the shares held by the Directors of a company are not shares in which the public are substantially interested is incorrect. According to learned counsel, all the authorities, the Tribunal and the High Court have proceeded on this wrong assumption, and have failed to apply the proper test laid down by the Explanation to the third proviso. It may be pointed out that there is no dispute that 551 shares, were, in fact, held by the public. The total shares of the Company being 10,000, the Company can only avoid the application of s. 23A, if the public hold shares carrying not less than 25 per cent. of the voting power, that is to say, 2,500 shares. The

Directors between them hold 4,695 shares. These have been held by the High Court to be shares, which cannot be said to be beneficially held by the public. Even so, if the rest of the shares can be said to be held by the public, then the minimum 25 per cent. would still be reached. It was in this context that the shares of the sons of Maganlal, Bipinchandra, Harishchandra and Krishnakumar, were considered. If those shares can be said to fall outside the category of shares beneficially held by the public, then those shares along with the shares held by the Directors reduced the number of shares held by the remaining shareholders to less than 25 per cent. It was on this view that the case was remitted to the Tribunal by the High Court to obtain a further statement whether Maganlal Parbhudas was de facto controlling these three shareholders. Two questions, therefore, arise in this appeal. The first is whether the shares held by the Directors must always be regarded as not held by the public. The second is what is the meaning of the provision:

"a company shall be deemed to be a company in which the public are substantially interested, if its shares carrying not less than twenty-five per cent. of the voting power have been allotted unconditionally to, or acquired unconditionally by, and are at the end of the previous year beneficially held by the public." In this connection, we may point out that a ruling of the Privy Council appears to take a different view from that taken by the High Court, in regard to an Uganda Ordinance in pari materia with the proviso and the Explanation. We shall refer to that case as also to a case of the House of Lords, where also a different conclusion in law from that of the High Court has been reached.

Section 23A (as it stood prior to its amendment in 1955), omitting the portions not material, read as follows: "23A. Power to assess individual members of certain companies.-Where the Income-tax Officer is satisfied that in respect of any previous year the profits and gains distributed as dividends by any company up to the end of the sixth month after its accounts for that previous year are laid before the company in general meeting are less than sixty per cent. of the assessable income of the company of that previous year, as reduced by the amount of income-tax and super-tax payable by the company in respect thereof he shall, unless he is satisfied that having regard to losses incurred by the company in earlier years or to the smallness of the profit made, the payment of a divi- dend or a larger dividend than that declared would be unreasonable, make with the previous approval of the Inspecting Assistant Commissioner an order in writing that the undistributed portion of the assessable income of the company of that previous year as computed for income-tax purposes and reduced by the amount of income-tax and super- tax payable by the company in respect thereof shall be deemed to have been distributed as dividends amongst the shareholders as at the date of the general meeting aforesaid, and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purpose of assessing his total income:

> ..... Provided further that this sub-section shall not apply to any company in which the public are substantially interested or to a subsidiary company of such a company if the whole of the share capital of such subsidiary company is held by the parent company or by the nominees thereof.
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> Explanation.-For the purpose of this sub-section a company shall be deemed to be a company in which the public are substantially interested if shares of the company carrying not less than twentyfive per cent. of the voting power have been allotted unconditionally to, or acquired unconditionally by, and are at the end of the previous year beneficially held by the public..... and if any such shares have in the course of such previous year been the subject of dealings in any stock exchange or are in fact freely transferable by the holders to other members of the public."

It is clear from the third proviso that the sub-section does not apply to a company in which the public are substantially interested. The Explanation lays down, among the tests, the minimum interest which can be called substantial' by saying that shares of the company carrying not less than 25 per cent. of the voting power must be allotted unconditionally to, or acquired unconditionally by, the public and they must be beneficially held by the public. The essence of the Explanation lies not in the percentage which only shows the limit of the minimum holding by the public, but lies in the words "unconditionally" and "beneficially". These words underline the fact that no person who holds a share or shares not for his own benefit but for the benefit of another and who does not exercise freely his voting power, can be said to belong to that body, which is designated 'public'. The word 'Public' is used in contradistinction to one or more persons who act in unison and among whom the voting power constitutes a block. If such a block exists and possesses more than seventy-five per cent. of the voting power, then the company cannot be said to be one in which the public are substantially interested. In Sardar Baldev Singh v. The Commissioner of Income-tax, Delhi and Ajmer (1), this Court took the following view:

> "The section thus applies to a company in which at least 75 per cent. of the voting power lies in the hands of persons other than the public, which can only mean, a group of persons allied together in the same interest. The company would thus have to be one which is controlled by a group. The group can do what it likes with the affairs of the company, of course, within the bounds of the Companies Act. It lies solely in its hands to decide whether a dividend shall be declared or not."

judged from the test we have indicated, it is clear that such a group may be formed by the Directors of a company acting in concert, or by some Directors acting in concert with others or even by some , shareholder or shareholders, none of whom may be a Director. Such a group which may, for convenience, be (1) [1961] 1 S.C.R. 482.

designated a block, must hold a controlling interest, and if the voting power of the block is 75 per cent. or more, then obviously it can do anything at a meeting, whether general or special.

When a company starts, the promoters may subscribe a portion of its capital and release the other unconditionally to the public. This is a case of unconditional allotment of shares to the public. The public may also unconditionally acquire a portion of the shares which were previously held by the group which promoted the company. If at the end of the previous year 25 per cent. or more of the voting power is so held by the public, the company can take the benefit of the third proviso. But if more than 75 per cent. of shares have again passed into the hands of a group which acts as a block, the third proviso ceases to apply.

In deciding if there is such a controlling interest, there is no formula applicable to all cases. Relationship and position as Director are not by themselves decisive. If relatives act, not freely, but with others, they cannot be said to belong to that body, which is described as 'public' in the Explanation. But it would be otherwise if they were free. Similarly, if Directors or some of them do not act as a body or in concert with others, the fact that they are Di- rectors is of no significance. The case of Tatem Steam Navigation Co., Ltd. v. Commissioners of Inland Revenue (2) illustrates the first proposition. There, the assessing Commissioners had made directions under s. 21 of the Finance Act, 1922, against which the Company appealed on the ground that it was a Company in which the public were substantially interested, inasmuch as shares of the Company carrving not less than 25 percent. of the voting power had been allotted unconditionally to or acquired unconditionally by, and were, at the end of the relevant periods, beneficially held by the public and the decision of the Special Commissioners that 16,000 shares given by Lord Glanely to his niece were not allotted to or acquired by the public and that the Company was, therefore, not (1) (1941) 24 T.C. 57.

a Company in which the public were "substantially interested" was erroneous. It was held by Lawrence, J., that merely because she was a niece of Lord Glanely did not make her cease to be a member of the public. The Court of Appeal agreed with Lawrence, J. No doubt, there were other provisions which laid down the kind of relationship which would lead to the inference that the holder was controlled by another, and a niece was not such a relative. The Act we are considering did not lay down the kind of relationship which would show such a control, and the same principle will apply. Mere relationship thus is not of consequence, unless control of the voting power held by such a relative, by another relative, is proved.

The other test adopted in the case by the Bombay High Court that Directors stand outside the 'public' is also not decisive. In Commissioner of Income-tax v. H. Bjordal (1), the Judicial Committee dealt with s. 21(1) of the Income Tax Ordinance No. 8 of 1940 (Uganda), as amended by s. 5 of the Income Tax (Amendment) Ordinance, 1943. That provision of law is completely in pari materia with s. 23A. Two brothers, H. Bjordal and S. Bjordal, held 73.96 and 25.09 per cent. of the voting power. Five others held 04 per cent. of the voting power. The shares held by S. Bjordal were purchased for full value by him from his brother. There was no suggestion that he was a nominee of the respondent or that he was acting in concert with his brother. Both brothers were Directors of the Company. It was held by the Judicial Committee that shareholders in a company who are members of the 'public' do not cease to be so, because they become Directors. In the Uganda Ordinance also, like our Act, there was no guidance as to the meaning of the word 'public', as there was in the English statute considered in Tatem's case (2).

It is significant that in Jubliee Mills Ltd. v. Commissioner of Income-tax (3), Chagla, C. J., and S. T. Desai, J., speaking of the judgment under appeal and (1) [1955] A.C. 309. (2) [1941] 24 T.C. 57.

(3) [1958] 34 I.T.R. 30, 41.

taking into consideration the Privy Council case, observed:

> "It may be that our view is erroneous; and it may be-and very probably it is-that the view taken by the Privy Council is the right one."

In our judgment, the test is first to find out whether there is an individual or a group which controls the voting power as a block. If there be such a block, the shares held by it cannot be said to be "unconditionally" and "beneficially" held by members of the public. In the category of shares held by the public, only those shares can be counted which are unconditionally and beneficially held by the public, or, in other words, which are uncontrolled by the group, which controls the affairs. The group itself may be composed of Directors or their nominees or relations in different combinations, but none can be said to be.long to that group, be he a director or a relative unless he does not hold the shares unconditionally and beneficially for himself. It is only such a person, who can fall properly outside the word 'public'.

Judged from this point of view, the judgment and orders of the High Court cannot be upheld. Directors cannot, by reason of being Directors, be said not to be members of the public. To that extent, the judgment is erroneous. There is a finding by the Tribunal in the supplementary statement of the case that the shares held by Bipinchandra, Harishchandra and Krishnakumar were under the control of their father, Maganlal Parbhudas. Their holding was 3,000 and with Maganlal's holding of 1,344 shares, makes up a total of 4,344 shares. Though the question as framed by the High Court appears to have been correctly answered in the negative, it does not dispose of the matter. The, question to be determined still is whether more than per cent. of the shares are not beneficially held by the public. We accordingly set aside the judgment and orders of the High Court, and direct the High Court to decide the question originally framed by it, viz.:

> "Whether on the facts and circumstances of the case the provisions of s. 23A of the Indian Income-tax Act, XI of 1922, are applicable to the petitioners?"

The High Court may call for a supplemental statement of the case from the Tribunal, if it finds it neces sary. The appeal is allowed. The respondents shall bear the costs of this appeal. The costs in the High Court shall abide the result.

Appeal allowed.