

Juggi Lal Kamlapat vs Commissioner Of Income-Tax, U.P. on 4 September, 1968

Equivalent citations: AIR1969SC932, [1969]73ITR702(SC), [1969]1SCR988

Bench: A.N. Grover, J.C. Shah, V. Ramaswami

JUDGMENT

Ramaswami J.

1. These appeals are brought by special leave from the judgment of the a Allahabad High Court dated July 10, 1962, in Income tax Miscellaneous Cases Nos. 255 and 256 of 1955.

2. The appellant, M/s. Juggilal Kamlapat, hereinafter called the "assessee", was a registered partnership firm having the following constituents :

Names of the partners shares

1. Shri S. M. Bashir 49 per cent.
2. Sri Padampat Singhanian 17 per cent.
3. Shri Lakshmipat Singhanian 17 per cent.
4. Sri Kailashpat Singhanian 17 per cent.

Total 100 per cent.

3. The shareholding of the three Singhanian brothers was 51 per cent. constituting a majority of the shareholding in the partnership firm. The partners of the said firm floated a company, namely, M/s. J. K. Kron and Steel Company Ltd., the constitution of which was that the three Singhanian brothers and their wives had 166 shares while Sri S. M. Bashir and his wife had 42 shares. In consideration of the fact that the assessee firm promoted the company the assessee was appointed the managing

agent of M/s. J. K. Iron and Steel Company Ltd. for a period of 25 years under a managing agency agreement dated December 15, 1938. It was provided in this agreement that the assessee will continue to be the managing agent until it resigned or it was removed from its office of managing agency by a majority of 3/4th of the shareholders of the managed company. According to the terms of the agreement the managing agent's remuneration was Rs. 1,500 per month and a commission of 10 per cent on net profits of the company after deducting all expenses and after charging depreciation. There was no provision in the Articles of Association of the managed company for terminating the managing agency except in the case of the managed company being wound up in which case, the managing agents were to receive compensation for loss of appointment. There was also the exception provided under the general law in case of fraud or gross negligence on the part of the managing agents. The relevant terms of the managing agency agreement were as follows :

4. Para 2(m) : "It shall be lawful for the firm to assign their officer as agents and all the rights and obligation as such agents and in the event of assignment, the assignee or assignees shall be deemed to have been appointed agents of the company with like powers and authorities remuneration and emoluments and subject to like terms and conditions as are herein contained....."

5. Para 2(c) : "The firm may at their option from time to time lend and advance to and for the use of the company, money on interest to any extent as they may like, the same to run at a minimum rate of five per cent. per annum provided that if the bank rate prevailing at the date of advance is higher than five per cent. The firm may charge interest at one per cent. above the bank rate."

6. On August 12, 1943, a meeting of the board of directors of the managed company was held. The directors present were : (1) Sri Padampat Singhania, (2) Sri Lakshmipat Singhania and (3) Sri S. M. Bashir with Sri Padampat Singhania in the chair. At this meeting a letter dated August 3, 1943, for M/s. Juggilal Kamlapat, Bankers, the financiers of the managed company, asking for re-payment of advances made by the financier to the company exceeding Rs. 5 lakhs was discussed. Sri. S. M. Bashir pointed out that the managing agents were under no obligation to provide finance for the company at the latter's direction. It was the option of the firm to provide or not to provide finance and also to determine the extent of the advance. Sri Padampat Singhania thereupon pointed out that even though the matter of providing finance might be at the discretion of the managing agents "it was the usual practice with companies under the management of the managing agents to obtain their finance from the managing agents". Accordingly the meeting decided to ask the assessee to arrange for advance of such sums of moneys as would be necessary to pay off the loan of the financiers M/s. Juggilal Kamlapat Banker and also to equip the company with working capital. A resolution was accordingly passed at the meeting to that effect. On August 19, 1943, the company addressed a letter to the assessee informing it of the resolution and asking it to make immediate arrangement for an amount which would not only reduce the account of M/s. Juggilal Kamlapat Bankers to a figure of Rs. 5 lacs but must also provide the company with working capital. The assessee replied to this communication by a letter dated August 31, 1943 in which the assessee pointed out that under the terms of the managing agency agreement it was not obligatory upon it to make advances to the managed company. The assessee stated that it had been specially constituted to act as the managing agent of the managed company and had no capital of its own. It had no assets also on the security of which it could raise a sum of Rs. 30 lacs which would be necessary to reduce

the amount of M/s. Juggilal Kamlapat Bankers to the limit required by the managed company and to equip the company with working capital. The letter of the assessee was considered by the managed company at the meeting of its Board of Directors on September 2, 1943. Sri Lakshmipat Singhanian, one of the Directors of the managed company reported in the meeting that a new floated company under the name and style of J. K. Commercial Corporation was willing to make advance provided it was appointed the managing agent of the company. Sri Bashir pointed out that the managed company had reached a stage when it would make substantial profits and enable the assessee to earn better remuneration and that it would be unjust to ask the assessee to relinquish office on a ground which did not constitute a term of the contract between the assessee and the managed company. Sri Padampat Singhanian who presided over the meeting recognised that the assessee would be adversely affected and he therefore suggested that the company should pay a fair compensation in consideration of the premature termination of the managing agency. A compensation of Rs. 2 lacs was worked out and Sri Bashir agreed to accept the amount for the termination of the managing agency on behalf of the assessee. It was decided that the sum of Rs. 2 lacs should be paid as soon as an agreement was arrived at with the J. K. Commercial Corporation for taking over the managing agency of the company. The managing agency of the assessee was thereafter terminated with effect from November 1, 1943 and M/s. J. K. Commercial Corporation were appointed the managing agents with effect from that date.

7. The constitution of M/s. J. K. Commercial Corporation was as follows :

'A' Class ordinary shares of Rs. 100 each Rs.

'B' Class ordinary shares of Rs. 10 each Rs.

I.

(a)

Sri Padampa
1,750					
5,000					

(b)

lady Ansuya Singhanian wife of Sri Padampat
(natural guardian of her minor son Gopal Hari.)

(c)

Lady Ansuiya Singhaniya (Natural guardian of her minor son Ch. Gaur Hari.)
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II.

(a)

Lala Kailashpat Singhania.
1,750			
5,000			

(b)

Lala Kailashpat, (Natural guardian of his minor son Vijaypat)
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III.

(a)

Lala Lakshmipat Singhania
1,000			

(b)

Shrimati Pushpawati Devi wife of Lakshmipat her minor son (natural guardian of Harishankar).

IV.

(a)

Lala Radhakishan Singhania uncle of Sri Padampat.
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(b)

Lala Purshottamdas Singhania cousin of Sri Padampat.
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(c)

Lala Sohan Lal Singhania cousin of Sri. Padampat.
1,000					
2,000					

V.

(a)

Shri P.D. Chandra Rana. P.A. to Sri Padampat.

(b)

Shri Gorikkishan Jaipuria Munim of J.K. Kanpur
(Kothi)

(c)

Shri S.M. Bashir, Director J.K. Iron and Steel Co.,
Ltd.

(d)

Lala S.D. Garg

(e)

Lala Sital Prasad, Director of J.K. Woollen
Mills.

1,900

TOTAL

8,530

15,000

8. It is apparent from this constitution that the shares of the three Singhanias brothers, their wives and children in J. K. Commercial Corporation Ltd. were 6,600 'A' class ordinary shares out of 8,580 and 11,000 out of 15,000 'B' class ordinary shares. The remaining shares were allotted to the personal assistant to Sri Padampat Singhanias, a munim of the firm of Juggilal Kamlapat, a director of the managed company, one S. D. Garg and to a director of an allied concern.

9. M/s. J. K. Commercial Corporation Ltd. were appointed managing agents for a period of 20 years, renewable thereafter for a term not exceeding 20 year at a time. The remuneration was to be an officer allowance of Rs. 1,000 per month, a commission of 10% on the net annual profits of the company and a commission of 2 1/2% on the gross sales of the products of the company. Paragraph 8 of the managing agency agreement states :

"The managing agents shall from time to time lend and advance to and for the use of the company such moneys as may from time to time be required by the company up to an amount not exceeding Rs. 20,00,000 at any one time, but they may, however at their option lend and advance even more money if so required by the company. The company shall pay to the managing agents, interest on moneys so lent and advanced at a rate to be mutually agreed upon from time to time."

10. The amount of Rs. 2 lakhs compensation paid to the assessee-firm was worked out on the basis of 5 preceding years' profits of the managing agency from November 1, 1938, to October 31, 1943. The sum of Rs. 2 lakhs was paid to the assessee on October 31, 1943. The amount was claimed by the assessee as compensation for loss of office not liable to tax under the Income-tax Act as a capital receipt. The receipt of this sum of Rs. 2 lakhs, though incorporated in its books by the assessee, was not disclosed at the time when the assessment was originally made against it on April 6, 1945. Late on who it was discovered that the assessee had received the sum from the managed company the assessment was reopened under section 34 of the Income-tax Act and proceedings were also taken under section 15 of the Excess Profits Tax Act for the corresponding chargeable accounting period and the amount was included in the total computation of the assessee's business income. The assessee challenged these assessments on the ground that the proceedings under s. 34 of the Income Tax Act and under s. 15 of the Excess Profits Tax Act were invalid and on merits therefore there was no justification for the inclusion of the sum of Rs. 2 lacs as its business income liable to tax. Both these contentions were rejected by the Income Tax Officer and by the Appellate Assistant Commissioner in appeal. The assessee thereafter preferred second appeals to the Income Tax Appellate Tribunal. In these appeals the assessee abandoned the contention regarding the legality of the proceedings under s. 34 of the Income Tax Act and s. 15 of the Excess Profits Tax Act and confined its argument merely to the point that the sum was not liable to be charged to tax. The Appellate Tribunal came to the following findings of fact: The three Singhanias brothers, Padampat, Lakshmipat and Kailashpat held 51 per cent share in the assessee firm. They and the members of their family held a large majority of shares both in J. K. Commercial Corporation Ltd. and in the managed company. There was no contract by reason of which the assessee was under any obligation to finance the business of the company. It was a false allegation on the company's part that it would be derogatory to its reputation to mortgage the property of the company to raise finance and the only alternative was to seek a party who might be willing and able to finance the company even if such a course warranted a change of the managing agents. For the new managing agents advanced loan to the company only on the pledge of the goods of the company (vide balance sheets of the company annexures I. J. and K.). It will also appear from these balance sheets that Juggilal Kamlapat Bankers still continued to be the creditors of the company in the three years for which the balance sheets have been filed in the sums of Rs. 3,13,169-11-6, Rs. 8,89,323-13-6 and Rs. 6,06,691.

On these findings the Appellate Tribunal came to the conclusion that the reasons given by the assessee for terminating the managing agency were not true and the sum of Rs. 2 lacs was not compensation for loss of office but was payment referable to the business of the assessee as managing agents of the Company. The Appellate Tribunal described the transaction of the termination of the managing agency as "collusive" and "not genuine" and that the "payment was not compensation for any loss" as in the view of the Appellate Tribunal no loss was sustained by the assessee. At the instance of the assessee the Appellate Tribunal stated a case to the High Court under s. 66(1) of the Income Tax Act on the following question of law :

11. "Whether there was material on which the Tribunal could hold that the receipt of Rs. 2,00,000 by the assessee was revenue receipt liable to tax under the Income-tax Act and the Excess Profits Tax Act ?"

12. By its judgment dated July 10, 1962, the High Court answered the question against the assessee and in favour of the Commissioner of Income-tax, U. P. the High Court took the view that the amount of Rs. 2 lakhs was received by the assessee "by virtue of its office" and "relate to the work of the managing agency" even though the payment was collusive and there was no real termination of the managing agency agreement. It was points doubt by the High Court that the collusive payment could not have been made if the assessee had not been the managing agent of the managed company and the managing agency business of the assessee was exploited for getting the amount of Rs. 2 lakhs.

13. On behalf of the appellant Mr. Sukurmar Mitra stressed the argument that the High Court failed to appreciate that the assessee-firm was a distinct legal entity and was different from J. K. Commercial Corporation which was a separate legal entity in the eye of law and the mere fact that the shareholdings of the partners of the assessee- firm in the J. K. Commercial Corporation was of a considerable preparation should not have led the High Court to the inference that the rights of the assessee-firm were not destroyed, sterilized or lost on account of the transaction. To put it differently, the contention of the appellant was that the High court was not entitled to go behind the legal from of the transaction and to find out what was the substance. We are unable to accept the argument of Mr. Sukumar Mitra as correct. In the present case the Appellate Tribunal has found that the transaction of termination of the managing agency was a colourable transaction and the real purpose was to hand over a sum of Rs. 2 lacs to the assessee firm. It was also found that the payment was collusive and the partners of the firm continued to run and enjoy the benefit of managing agency as shareholders and Directors of the newly formed company by reason of their holding a majority of shares in that company. It was also held by the Appellate Tribunal that the reason for terminating the managing agency was not a true reason but was merely a fake one and the whole transaction was a hoax for the purpose of evading income-tax. In other words, it was a collusive device practised by the managed company and the assessee firm for the purpose of evading income-tax both in the hands of the payer and of the payee. The Appellate Tribunal also found that there was only a change of personnel in the managing agency and not a change in office and that the assessee had no right of compensation for any loss of office. In a matter of this description it is well-established that the Income-tax authorities are entitled to pierce the veil of corporate entity and look at the reality of the transaction. It is true that from 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 or to perpetrate fraud. For instance, in *Apthorpe v. Peter Schoenhofen Brewing Co.* (4 T.C. 41) the Income Tax 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 Commissioners also found, if the business was technically that of 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* ([1897] A.C. 22) case held that the New York business was that of the English company which was liable for English income tax accordingly. In another case *Firestone Tyre and Rubber Co. v. Llewellyn* ([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 company 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 by the House of Lords that the substance of the arrangement was that the American company traded in England through the agency of its subsidiary. It was accordingly held that the trade of selling tyres to persons outside the United Kingdom was carried on within the United Kingdom and was exercised by the American company through the English Co. as its agent. Therefore, the tax was chargeable in respect of that trade under Schedule D, para 1(a)(iii), to the Income Tax Act, 1918, and the English Co. was the regular agent of the American Co. in whose name it was properly assessed to tax on profits of that trade under rules 5 and 10 of the All Schedules Rules. In our opinion the principle applies to the present case, and the Court is entitled to lift the mask of corporate entity if the conception is used for tax evasion or to circumvent tax obligation, or to perpetrate fraud. We accordingly reject the argument of Mr. Sukumar Mitra on this aspect of the case.

14. We proceed to consider the next argument addressed on behalf of the assessee, viz., that the amount of Rs. 2 lakhs cannot be held to be a revenue receipt even though the transaction of termination of the managing agency was collusive and the intention of the parties was to evade income-tax. The argument put forward on behalf of the appellant was that, even if the transaction was collusive and not genuine, it was legally permissible for the assessee to arrange its affairs in such a way as to avoid the incidence of tax. It was argued that even upon the facts found by the Appellate Tribunal the amount of Rs. 2 lakhs paid to the assessee-firm was not taxable as income in its hands because there was an actual termination of the first managing agency agreement and the amount of Rs. 2 lakhs was actually paid to the assessee-firm for the termination of the managing agency contract. The argument was stressed that the assessee firm had no other business activity except the managing agency in question and that the managing agency constituted the capital assets of the assessee firm and on the termination of the managing agency contract the capital assets were

"destroyed or sterilized" and the compensation received was therefore of the nature of a capital receipt. In our opinion, there is no warrant for the argument addressed by Mr. Sukumar Mitra. On the facts found in this case, it is manifest that the managing agency business carried on by the assessee firm was not destroyed or lost to the four individual partners who constituted the assessee firm. What happened was that the individuals who constituted the assessee firm became the Directors of the newly formed company namely, J. K. Commercial Corporation and in this new capacity they undertook the conduct of the managing agency business and as shareholders continued to benefit from the profits of that business flowing to them in the shape of dividend instead of as a share of profits from the assessee firm. In other words, the managing agency asset was enjoyed by the four individual partners in a different capacity with the same object of profit-making. There was, therefore, no destruction of the apparatus of the profit-making asset i.e., the managing agency contract. The Appellate Tribunal has found that the amount of Rs. 2 lacs was received by the assessee firm "by virtue of its office" and "related to the work of the managing agency" even though the termination of the contract was not genuine and the payment was collusive and the managing agency business of the assessee firm was exploited for gaining Rs. 2 lacs. It is obvious that there is an intimate connection in this case between the managing agency business of the assessee firm and the payment of a sum of Rs. 2 lacs and there was therefore proper material before the Appellate Tribunal in support of its finding that the receipt of Rs. 2 lacs by the assessee firm was a receipt in the course of its managing agency business and was hence a revenue receipt.

15. On behalf of the appellant it was said by Mr. Sukumar Mitra that a mere intention on the part of the assessee to evade income-tax will not nullify an otherwise lawful transaction. But we have already shown that the Appellate Tribunal has found in the present case that the transaction of termination of the managing agency contract was sham transaction and was stage-managed merely with a view to evade income- tax and the real intention was that the three Singhanian brothers should continue to carry on the managing agency in a dominant capacity in the guise of a limited company and there was in fact no loss of office or destruction of profit yielding apparatus. Reference should be made in this connection to the following observations of Lord Greene M. R. in *Lord Howard De Walden v. Commissioners of Inland Revenue* (25 T.C. 121, 134) :

"But even if the only alternative to Mr. Tucker's construction is the second of the three constructions, we are not prepared to say that it is necessarily as unjust as he contends. The section is a penal one and its consequences whatever they may be, are intended to be an effective deterrent which will put a stop to practices which the Legislature considers to be against the public interest. For years a battle of manoeuvre has been waged between the Legislature and those who are minded to throw the burden of taxation off their own shoulders on to those of their fellow subjects. In that battle the Legislature has often been worsted by the skill, determination and resourcefulness of its opponents, of whom the present Appellant has not been the least successful. It would not shock us in the least to find that the Legislature has determined to put an end to the struggle by imposing the severest of penalties. It scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt figures."

16. We therefore reject the argument of Mr. Sukumar Mitra on this point.

17. For the reasons expressed, we hold that the judgment of the Allahabad High Court dated July 10, 1962, is correct and these appeals must be dismissed with costs-one set of hearing fee.

18. Appeals dismissed.