

# **Commissioner Of Income-Tax, West ... vs East Coast Commercial Co. Ltd on 11 October, 1966**

**Equivalent citations: 1967 AIR 768, 1967 SCR (1) 821, AIR 1967 SUPREME COURT 768**

**Author: J.C. Shah**

**Bench: J.C. Shah, V. Ramaswami, Vishishtha Bhargava**

PETITIONER:  
COMMISSIONER OF INCOME-TAX, WEST BENGAL

Vs.

RESPONDENT:  
EAST COAST COMMERCIAL CO. LTD.

DATE OF JUDGMENT:  
11/10/1966

BENCH:  
SHAH, J.C.  
BENCH:  
SHAH, J.C.  
RAMASWAMI, V.  
BHARGAVA, VISHISHTHA

CITATION:  
1967 AIR 768                      1967 SCR (1) 821  
CITATOR INFO :  
R                      1976 SC1141 (14)

ACT:  
Income Tax Act (11 of 1922), s. 23-A--company in which public are not substantially interested-Test for. Taxation of Income (Investigation Commission) Act, 1947 declared ultra vires-Admissions recorded by Authority acting under Act-Admisibility in evidence.

HEADNOTE:  
Members of a family held 4,015 shares, out of 4,391 shares in the respondent company, which was a public limited Company. In the course of investigation under the Taxation of Income (Investigation Commission) Act, 1947, the heads of the various branches of the family admitted that the shares

were purchased by them out of their joint income which had not been disclosed and that a majority of the shares were held benami. An offer of settlement was also made that a single assessment may be made in respect of the "secreted income" treating them as an association of persons and that every member of the family be treated as jointly and severally liable to pay tax on that income. For the assessment years 1950-51 and 1951-52, the Income-tax Officer commenced proceedings under s. 23A of the Income-tax Act, 1922, and held that the Company was one in which the public were not substantially interested and that its affairs were under the control of the members of the family. He passed an order under the section that the undistributed portion of the assessable income of the Company as computed for income-tax purposes and reduced by the amount of income-tax and super-tax shall be deemed to have been distributed as dividends among the share-holders. The order was confirmed by the Appellate Assistant Commissioner. The Income-tax Appellate Tribunal reversed the order. The Tribunal held that the offers made by the members of the family to the Income-tax Investigation Commission were not relevant in determining whether the Company was one in which the public were not substantially interested, and that from the fact that the members of the family held 4,015 shares, it could not be inferred that the shares were jointly acquired, or that the members exercised control over the affairs of the Company. The Tribunal also observed that there was no material placed by the Department to show that the members of the family actually controlled the voting or acted in concert so as to bring the company within s. 23A. The Tribunal, therefore, held that the section did not apply to the Company since it was not established that the Company was one in which the public were not substantially interested, even though the members of the family held more than 75% of the shares issued by the Company. On a reference, the High Court confirmed the order of the Tribunal holding that even on the finding that the members of the family were in a position to control the affairs of the Company, there was no evidence of any overact showing that they were acting in concert and thereby constituted a block.

In appeal to this Court,

HELD : The approach to the problem by the Tribunal and High Court was erroneous. It was for the Tribunal to determine, having regard to ordinary human experience whether it may be safely taken that the members of the family must have acted together as a controlling block. That

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enquiry had not been made and the case was decided on the application of an erroneous test. [830 C-D]

(i) In deciding whether an order under s. 23A (as on the relevant date) is called for, it must be decided in the first instance whether there was a of persons acting in

concert holding a sufficient number of shares may control the voting as a block. It is sufficient, if having regard to their relationship, their conduct, their common interest etc. it may be inferred that they must be acting together : evidence of actual concerted acting is normally difficult -to obtain and is not insisted upon. It is the holding in the aggregate, of a majority of the shares issued, by a person or persons acting in concert in relation to the affairs of the company which establishes the existence of a block, and if the block holds 75% of the voting power it shall be deemed that the company is one in which the public are not substantially interested. To establish that a company is one in which the public are not substantially interested,, it is not a condition that actual exercise of control by a group must be established. [828 B, E-F; 829 F-H]

(ii) The fact that certain provisions of the Taxation of Income (Investigation Commission) Act were held to be ultra vires did not render the Commission an unlawful body, and the admissions recorded by the Commission could not be ignored. The report could be taken in evidence after giving an opportunity to the respondent to make its representation against the report and to tender evidence against the truth of the recitals contained therein. [830 B-D]

Raghuvanshi Mills Ltd. v. Commissioner of Income-tax, [1961] 2 S.C.R. 978 and Commissioner of Income-tax v. Jubilee Mills, [1963] Supp. 1 S. C. R. 83, followed.

#### JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 672 & 673 of 1965.

Appeals from the judgment and order dated August 17, 1962 of the Calcutta High Court in Income-tax Reference No. 32 of 1959;

S. T. Desai R. Ganapathy Iyer and R. N. Sachthey, for the appellant (in both the appeals).

A. K. Sen and D. N. Mukherjee, for the respondent (in both the appeals).

The Judgment of the Court was delivered by Shah, J. M/s East Coast Commercial Company Ltd. hereinafter called 'the Company'-disclosed in its return for the assessment years 1950-51 and 1951-52, a consolidated net profit of Rs. 8,89,241/- for the account period April 7, 1949 to July 16, 1950. The Income-tax Officer computed the income of the Company for the assessment year 1950-51 at Rs. 7,27,824/- and for the assessment year 1951-52 at Rs. 2,00,803/-. It came to the notice of the Income-tax Officer that the Company was one in which the public were not substantially interested within the meaning of s. 23A of the Income-tax Act, 1922, and that the distributable profit after deducting tax due on the total income was Rs. 4,32,151/- for the assessment year 1950-51, and Rs.

1,13,579/- for the assessment year 1951-52, and that the Company had distributed Rs. 43,910/- only as dividend. The Income-tax Officer commenced proceedings under S. 23A of the Income-tax Act, 1922, and passed an order that the undistributed portion of the assessable income of the Company as computed for income-tax purposes and reduced by the amount of income-tax and super-tax shall be deemed to have been distributed as dividends among the shareholders. The order was confirmed by the Appellate Assistant Commissioner. But the Income-tax Appellate Tribunal reversed the order. The Tribunal held that s. 23A did not apply to the Company since it was not established that the Company was one in which the public were not substantially interested.

At the instance of the Commissioner of Income-tax, three questions were referred to the High Court of Judicature at Calcutta. In these appeals the first question alone is material :

"Whether on the facts and in the circumstances of the case the Tribunal erred in law in holding that the assessee-company was one in which the public are substantially interested within the meaning of S. 23A of the Indian Income-tax Act ?"

The High Court answered that question in the negative. The Commissioner of Income-tax has, with certificate under s. 66A(2) of the Income-tax Act, 1922, appealed to this Court. Relationship between the members of the family jointly referred to as 'the Kedias' is explained by the following genealogy Jhabarmull Kedia (died in 1937)

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:           :           :           :
Nagarmull   Probladrai   Madangpal   Bnarashi.
(Died in 1928) (Died on 16-6-51)
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:           :
Mahabir Prosad   Purarumal
  
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The joint status between the members of the family was severed on July 4, 1943, and the members of the family formed themselves into a partnership and carried on the family business. Some time thereafter Benarashi Prosad and Puranmall retired from the partnership and started an independent business with an outsider in partnership. This business was taken over by a private company styled 'East Coast Commercial Company Ltd. Later the private company was converted into a public limited company bearing the same name and having a paid-up capital of Rs. 4,39,100/divided into 4,391 shares of Rs. 100/- each.

Investigation was started against the members of the Kedia family under the Taxation of Income (Investigation Commission) Act, 1947. In the course of the investigation the heads of the four branches of the Kedia family admitted that the shares in the respondent company numbering 4,115 were purchased by them out of their joint income which had not been disclosed and a majority of the shares in the Company was held benami. An offer of settlement was then made by the members of the Kedia family before the Investigation Commission. In paragraph-26 of the report, the Commission observed as follows "These figures have been accepted by Madangopal Kedia for

himself and as manager of the joint Hindu family consisting of himself and his minor sons, Prosad Kedia for himself and as manager of family consisting of himself and his minor son as the executor and legal representative of his elder brother Prohladrai, Puranmal Kedia, and Prosad Kedia for himself and as manager of family consisting of himself and his son, and they have jointly filed a settlement application. Though these persons are now divided and separate assessments to income-tax are being made on each, they have admitted that so far as the secret profits in question were concerned, they were earned by all the members jointly and have, therefore, requested that a single assessment may be made, treating them as an Association of Persons and making each member and his joint family jointly -and severally liable for the tax."

It appears that 2,000 shares of the Company were standing in the name of Durgadutt Jhunhunwalla who had declared himself to be the sole proprietor of the business styled 'Mohanlal Murarilal' carried on in the State of Hyderabad. It was found in the course of the investigation before the Investigation Commission that the shares were held by Durgadutt Jhunhunwalla benami for the members of the Kedia family. By letter dated December 18, 1951 it was admitted by them that Durgadutt Jhunhunwalla was only a "working partner" having a tenth share and that the entire capital of the firm - had been advanced by the Kedias jointly. Out of the 2,000 shares -registered in the name of Mohanlal Murarilal, 1,000 shares were then transferred to the executor of the estate of Prohladrai Kedia and the balance was taken over by Durgadutt Jhunhunwalla on January 30, 1951, when his account was finally settled, his personal account being credited with the sum of Rs. 1,00,000/- representing his remuneration for services rendered till October 20, 1949 and he being debited with that sum representing the value of 1,000 shares made over to him. Therefore upto the account year 1951-52 in the 1,000 shares held in the name of Durgadutt Jhunhunwalla the members of the Kedia family had a 9/10th share.

By September 17, 1952 the members of the Kedia family got all the shares transferred to their own names from the benamidars. The share-holding of the various, members of the family thereafter was as follows

1. Madangopal Kedia 120 shares
2. Benarshi Prosad Kedia 495 shares
3. Prohladrai Kedia 1,389 shares
4. Purnamal Kedia 650 shares
5. Mahabir Prosad Kedia 461 shares (Out of 1,389 shares held in the name of Prohladrai Kedia, 1,000 shares were those which were transferred by Durgadutt Jhunhunwalla).

Taking into account 900 shares-being 9/10th share of the holding of 1,000 shares which were transferred on January 30, 1951 in the name of Durgadutt Jhunhunwalla, the total holding of the members of the Kedia family in the Company therefore stood at 4,015 shares. This holding was in excess of seventy-five per cent of the total number of the shares issued by the Company.

The Income-tax Officer held that Madangopal Kedia and others formed an association of persons. In his view 4,115 shares had been purchased benami out of the income earned jointly by the members of the family and that the income was invested by them as an association of persons, and that there was no evidence that the income from those shares was taken individually by the members of the family, who even after disruption of the joint family on July 4, 1943, had continued to work together and make their investments as an association of persons. The Income-tax Officer further held that since the shares were never quoted in the market and the affairs of the Company were under the control of the members of the Kedia family, an order under s. 23A of the Income-tax Act could appropriately be made. In appeal, the Appellate Assistant Commissioner agreed with the Income-tax Officer and held that the shares were acquired jointly by the members of the family out of their "joint secreted earnings". The Appellate Assistant Commissioner also proceeded to and lyse the minutes of the meetings of the Company showing the attendance at the meetings of the Company held between April 10, 1946 and December 30, 1951 and held that the members of the Kedia family had controlled the affairs of the Company and on their admissions they had formed an association for acquisition of the shares of the Company, and for various Sup.C.I./66-8 other purposes, and therefore it could be inferred that the members of the association who controlled more than seventy five per cent of the total shares and the voting power had acted in concert.

But the Income-tax Appellate Tribunal held that the offers made by the members of the Kedia family to the Income-tax Investigation Commission that a single assessment be made in respect of their "secreted income" treating them as an association of persons and that every member of the family be treated as jointly and severally liable to pay tax on that income were not relevant in determining whether the Company was one in which the public were not substantially interested, and that from the fact that the members of the Kedia family held 4,015 shares, it could not be inferred that the shares were jointly acquired, or that the members of the family exercised control over the affairs of the Company. The Tribunal observed :

"....that unless and until the department clearly established by proper material that the Kedias were acting in concert there is absolutely no case for holding that the provisions of Section 23A become applicable to the facts of the case as in this case we have held that there is nothing to indicate that the separated members of the Kedia family acted in concert we hold that no case has been made out by the Department for holding that the assessee-company is one in which the public were not substantially interested."

The High Court expressed a doubt that the report made by the Income-tax Investigation Commission "may not be evidence of anything contained therein", and proceeded to observe :

"There is no doubt upon the facts stated above, that the five Kedias who held between them 3,115 shares, and also had an interest in the 1,000 shares of Messrs. Mohanlal Murarilal, were in a position to control the affairs of the Company. . . . In my opinion, Tribunal came to right conclusion. It may be that the holders of the shares are in a position to control the Company. The majority of shareholders may be directors or relatives of directors or relatives of shareholders. But, that is not by itself sufficient to

satisfy the test. There must not only be evidence to show that a number of individuals are in a position to control the company, but it must be shown that they are in fact acting in concert and they have constituted a 'block' so as to control the affairs of the company by themselves. This requires some overt act. . . . There is not a single fact to show that the Kedias or their nominees were in fact acting in concert or operating as a 'block'. The Tribunal was right in coming to the conclusion that no materials were placed before it by the Department to establish the fact that the Kedias in question acted in concert or operated as a block, so as to bring the assessee company within the provision of section 23A. "

By s. 23A(1) of the Income-tax Act as it stood in the relevant years the Income-tax Officer was required, if satisfied that in respect of any previous year the profits and gains distributed as dividends by any company were 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, to make an order that the undistributed portion of the assessable income of the company of that previous year shall be deemed to have been distributed as dividends among the shareholders as at the date of the general meeting. But - this power could not be exercised in respect of any company in which the public are substantially interested. By the. Explanation to s, 23A(1) it was enacted that "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 twenty-five per cent. of the voting power have been allotted unconditionally to, or acquired un- conditionally 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." This Court in *Raghuvanshi Mills Ltd. v. Commissioner of Income-Tax(1)* examined the scheme of S. 23A as it stood before the Finance Act of 1955 and observed :

"The word 'public' is used (in the Explanation) 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. . . .

the test is first to find out whether there is an individual or 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."

It is clear that in deciding whether an order under s. 23A(1) is called for, the Income-tax Officer must determine--(1) whether there is an individual or a group which can control the voting power as (1) [1961] 2S.C.R. 978-41 I.T.R. 613.

a block. The existence of such a block may be established by showing that the voting power is vested in persons possessing more than fifty per cent. of the shares issued who act in concert ; and (ii) that the block exercises a controlling interest over the affairs of the company. This condition is satisfied

only if the voting power of the block or group is seventy-five per cent or more. If the block holds seventy-five per cent of the voting power it shall be deemed that the Company is one in which the public are not substantially interested. On the other hand, if the members of the public hold shares of the company (not being shares entitled to a fixed rate of dividend, whether with or without a further right to participate in profits) carrying not less than twenty five per cent of the voting power allotted unconditionally to, or acquired unconditionally by them, the Company shall be deemed to be one in which the public are substantially interested.

It is unfortunate that the Tribunal did not record a finding whether there was a group of persons controlling the affairs of the Company. In the view of the Tribunal, since the acquisition of 4,015 shares of the Company was not joint and there was no other evidence that the members of the Kedia family were in fact acting in concert, the Company could not be deemed one in which the public were not substantially interested. The High Court also made a similar approach. They were of the view that even on the finding that the members of the Kedia family were in a position to control the affairs of the Company, there was no evidence of any overt act showing that they were acting in concert and thereby constituted a block.

In our judgment, that approach to the problem was erroneous. The Tribunal had to decide in the first instance whether there was a group of persons acting in concert holding a sufficient number of shares which may control the voting as a block. But the existence of a block is not decisive. If there be a group of persons holding control over voting, the Company would still be a Company in which the public are substantially interested, if twenty-five per cent. or more of the voting power has been, allotted unconditionally to and beneficially held by the public and the shares were in the previous years subject of dealings in any stock exchange in the taxable territories or were in fact freely transferable by the holders to other members of the public. The two enquiries are distinct. The Tribunal in paragraph 9 of its order observed that there was no material placed by the Department to show that the Kedias in question acted in concert so as to bring the assessee company within s. 23A. If thereby the Tribunal meant that there was no evidence to prove that the members of the Kedia family "actually acted in concert," the view taken by the Tribunal was, in our judgment, wrong, since to establish that a Company is one in which the public are not substantially interested, it is not a condition that actual exercise of control by a group must be established. The High Court was apparently of the view that the members of the Kedia family were in a position to control the affairs of the Company, but there was no evidence of any overt act or concert between them. But in Commissioner of Income-tax, Bombay City-, v. Jubilee Mills Ltd. (1) this Court held that no direct evidence of overt act or concert between the members of the group having control over voting was necessary to prove that the Company was not one in which the public were substantially interested. It was observed in Raghuvanshi Mills' case(2) that "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." In Jubilee Mills' case(1) this Court elaborated those observations and stated :

"The test is not whether they have actually acted in concert but whether the circumstances are such that human experience tells us that it can safely be taken that



they must be acting together. It is not necessary to state the kind of evidence that will prove such concerted acting. Each case must necessarily be decided on its own facts."

On an analysis of the reasons recorded by the Tribunal and the High Court, it is clear that the Tribunal held that the Kedias did not form a controlling group because there was no evidence that they actually controlled the voting, even though they held more than seventy-five per cent of the shares issued by the Company : the High Court observed that the members of the Kedia family held 4,015 shares of the Company and were in a position to control the affairs of the Company, but there was no evidence to show that they did in fact act in concert and controlled the affairs of the Company as a block. But, as already observed, if the members of the Kedia family formed a block and held more than seventy-five per cent of the voting power, it was not necessary to prove that they actually exercised controlling interest. It is the holding in the aggregate of a majority of the shares issued by a person or persons acting in concert in relation to the affairs of the Company which establishes the existence of a block. It is sufficient, if having regard to their relation etc., their conduct, and their common interest, that it may be inferred that they must be acting together : evidence of actual concerted acting is normally difficult to obtain, and is not insisted upon.

(1) [1963] Supp. 1 S.C.R. 83-48 I.T.R. 9. (2) [1961] 2 S.C.R. 978 We may observe that the High Court appears to have felt some doubt as to the admissibility of the report of the Income-tax investigation Commission. But the Income-tax authorities are not strictly bound by the rules of evidence, and the mere fact that certain provisions of the Taxation of Income (Investigation Commission) Act relating to the inquiries to be held were declared to be ultra vires by this Court did not render the Commission an unlawful body ; and in any event the admissions which are recorded by the Commission, as having been made before them, cannot be ignored. The report had evidence value and could be taken into account. Undoubtedly the report had to be brought to the notice of the Company, and the Company had to be given an opportunity to make its representation against the report and to tender evidence against the truth of the recitals contained therein. It is not suggested that this opportunity was not given. It was for the Tribunal to determine, having regard to ordinary human experience whether it may be safely taken that the members of the Kedia family must have acted together as a controlling block. That enquiry has not been made, and the case has been decided on the application of a test which is erroneous. We are, therefore, unable on the statement of case to answer the question referred.

We accordingly set aside the order passed by the High Court and direct that the Tribunal do submit a supplementary statement of the case under s. 66(4) of the Income-tax Act, 1922, because in our view the statement of the case already referred to is not sufficient to enable determination of the case raised thereby. The Tribunal may make such additions or alterations in the statement of the case in the light of the observations made in the course of this judgment. The Tribunal will submit the supplementary statement of the case to the High Court. The High Court will then proceed to determine the question according to law. The costs of this hearing will be costs in the proceedings before the High Court.

Order of High Court set aside with direction, to, the Tribunal to submit supplementary statement of the case. V.P.S.