

CALCUTTA HIGH COURT

Commissioner of Income-Tax

Vs

Tona Jute Co. Ltd

(G. K. Mitter J.)

06.02.1962

JUDGMENT

G. K. Mitter J.

This is a reference at the instance of the revenue for consideration of the question as to whether the shares of the assessee company were freely transferable within the meaning of section 23A of the Indian Income-tax Act in view of the provision of article 39 of its articles of association. The assessee is a "public company " within the meaning of the expression used in the Indian Companies Act of 1913. The assessment year in question is 1949-50, the relevant previous year having terminated on July 7, 1948. The total income of the assessee as finally determined under section 31(3)(a) on November 11, 1954, was Rs. 1,12,132. The tax thereon amounted to Rs. 49,058 leaving a balance of Rs. 63,074 available for distribution amongst the shareholders of the company. No dividends were declared at the annual general meeting held on July 9, 1949. For the purpose of the Indian Income-tax Act, however, and specially under section 23A of the Act so far as is relevant to this case, a company can only be deemed to be a company in which the public are substantially interested if its shares were at any time during the previous year the subject of dealing in any recognised stock exchange in India or were freely transferable by the shareholders to other members of the public. The Income-tax Officer held that article 39 of the articles of association of the company stood in the way of the assessee being considered "a company in which the public were substantially interested." The said article provides as follows :

"The directors may decline to register any transfer of share upon which the company has a lien and in case of shares not fully paid up may refuse to register transfer to a transferee of whom they do not approve. The directors may also in their absolute discretion refuse to register transfer of any share to any person whom it shall in their opinion be undesirable in the interest of the company to admit to membership. The directors shall not be bound to give any reason for refusal of transfer as aforesaid. No transfer shall be made to an

infant or person of unsound mind."

According to the Income-tax Officer this provision prevented the free transfer of shares, inasmuch as it was open to the directors to refuse to recognise any transferee whom they did not approve of and as they were not bound to give any reasons for their refusal the power of refusal was unrestricted. There being no dispute that shares of the company were not quoted in any official stock exchange the Income-tax Officer made an order that the entire undistributed profits of Rs. 63,074 should be deemed to have been distributed as dividends as on July 9, 1949. The attention of the Appellate Assistant Commissioner was drawn to the fact that, since the inception of the company in 1946, no less than 41 transfers had been effected up to 1953 when the matter came up before the income-tax authorities and that there had been no occasion for the directors to refuse registration of any transfer. The Appellate Assistant Commissioner, however, found that the transfers effected had always been to members of the same family or close associates of the directors. The assessee preferred an appeal to the Appellate Tribunal and the Tribunal has by a majority found that there was no restriction on the free transfer of shares imposed by article 39 and hence section 23A could not be invoked. The Accountant Member was in favour of the appeal being allowed while the Judicial Member took a different view. The President of the Tribunal, however, was of the same opinion as the Accountant Member and in the result the appeal was allowed. Under section 28 of the Indian Companies Act, 1913, the shares in a company are moveable property transferable in manner provided by the articles of association of the company. Unless the articles provide otherwise, the shareholder has a free right to transfer his shares to whomsoever he wills. In the case of a private company the articles must restrict the right of a member to transfer his shares and must also limit the number of members to 50 and must contain a restriction prohibiting invitation to the public for subscription to the shares. Regulation 20 of Table A which is a model article provides that "the directors may decline to register any transfer of shares not being fully paid shares to a person whom they do not approve of, and may also decline to register any transfer of shares on which the company has a lien." Article 39 of the articles of association of the assessee company goes a little further than that. Under this article it is open to the directors of the company to refuse to register transfer of shares to any person if they consider that it would be undesirable in the interest of the company to admit the transferee to membership and it was argued that this showed that the right of free transfer was being cut down by the article. Regulation 20 itself shows that the legislature thought that the company should have the power to refuse registration when the shares were not fully paid or when the company had a lien on the shares. This is because it was thought right that a person whose solvency was not beyond controversy should not be thrust upon a company. The question is does the power of a solvent person on another grounds restrict the right of free transfer. Where articles contain such a power the directors must before rejecting a proposed transfer fairly consider the question at a board meeting. If they do so they are not bound to disclose their

reasons and in the absence of evidence to the contrary the court will assume that they have acted reasonably and bona fide. The court can examine the reasons if they are given but the court will not overrule the decisions of the directors merely because it would not have come to the same conclusion itself. Ordinarily a member contracting to sell his shares to another merely undertakes to deliver genuine share scrips and transfer deeds duly signed and not do anything which might prevent the transferee from having the full benefit of the transfer. If the directors refuse to recognise the transferee the purchaser cannot recover the price from the seller but the latter must hold the shares as trustee for the purchaser and vote in the way the transferee directs him to and make over any benefits received by way of dividends, etc., from the company to the transferee. A transfer of a share does not take place as soon as a member whose name is registered in the books of the company executes a proper deed of transfer which is accepted by the transferee who in his turn fills up the transfer deed and sends it on to the company for registration of his name. It was pointed out as early as 1885 in *Societe Generale De Paris and G. Colladon v. Janet Walker* by the Earl of Selborne that "a complete legal title...could not be acquired without registration". From this it follows that there is no complete divesting of title until registration of the transferee's name. On behalf of the revenue our attention was drawn to section 28 of the English Companies Act of 1948 which is practically identical with section 2(13) of the Indian Companies Act, 1913, as amended up to 1936. A private company must by its articles of association restrict the right to transfer its shares and according to *Palmers Company Precedents*, 17th edition, page 687, "the restrictions on the right to transfer every share - to comply with the section - must be general; some shares must not be exempt from the restriction. It is sufficient for the purpose of the section to provide - in the terms of the common clause - that the directors may refuse to register any transfer of shares, but frequently the clause is supplemented." It was contended that a power given to the directors by the articles of association to refuse to register any transfer of shares without anything more was restrictive of the right of free transfer of shares which the members would otherwise have had. It was argued that there could be no question when such power was coupled with the right of refusal to give the reasons therefor.

In my opinion, the contention of the revenue is sound. The point of time as to when a transfer is complete was discussed at length by Eve J. in *In re Copal Varnish Co. Ltd.* In this case the company was at first a public company. Article 17 of its articles of association provided that "the directors may decline to register any transfer of shares made by any person who is indebted to the company for any money then due and payable or who may be solely or jointly liable to it for any call whether payable or not or any interest thereon or in respect of any debt notwithstanding that the same may not then be due, or where the proposed transferee is a person engaged in business of a similar character to the business of the company or who may otherwise be a competitor in trade with the company, or in any case where the directors shall consider the proposed transfer will not be conducive to the interest of the company." When the company was

turned into a private company the following words were added to article 17 by a special resolution :

"No share shall be transferred to any person who is not already a member of the company without the consent of the directors."

There were only two directors, Ernest Randall and Percy Randall, and the quorum of directors was two. Ernest Randall was the chairman of the directors. He executed transfers of twelve of his shares to twelve persons who were not members of the company without first obtaining the consent of the board of directors. These were sent for registration and a meeting of the directors was summoned by a notice containing among the agenda, "transfer of shares". Percy Randall persistently refused to attend at board meetings. The transferees took out a summons under section 32 of the Companies (Consolidation) Act, 1908, for rectification of the register of members by inserting their names as holders of the shares in the place of the name of Ernest Randall. In the course of his judgment the learned judge observed :

"The operation of legally transferring a share is indeed one of some complexity. In the first place there is the contract of sale followed by the execution of an instrument of transfer containing an agreement by the purchaser to accept the shares subject to the several conditions on which the vendor held the same immediately prior to the execution of the transfer - that is to say, subject, amongst other things, to the conditions imposing restrictions on the vendors right to transfer to that particular purchaser. Up to this point all that has been done is to pass an equitable interest in the shares to the transferee. There has been no legal assignment completed; indeed, the most crucial point in the transaction has not been reached - the acceptance of the transfer by the board of directors and the passing of it for registration; and even then the matter is not completed, because until the actual entry of the name of the transferee on the register the transferor remains the legal holder of the share."

In my view, the above clearly shows that a transfer of shares is not complete until registration of the name of the transferee if such registration cannot be insisted on as a matter of right and does not follow as a matter of course when a transfer deed duly completed is sent along with the share scrip to the company. In Howrah Trading Co. Ltd. v. Commissioner of Income-tax the Supreme Court dwelt at length on the rights of a transferee before registration. It was, however, contended that transferability and registrability of shares are entirely different and even though registration might be refused the transfer was complete. Further it was argued that if the articles do not lay down that a person proposing to transfer his shares has to do something before executing the transfer deed the same was freely transferable. I find myself unable to accept this contention. Transferability and registrability go hand in hand. The articles of association of some private

companies do indeed provide that a member proposing to transfer his shares must give notice to the directors who in their turn must first find out whether any other member is willing to take up the shares is (sic) the transferee in a position to part with them in favour of a third person. Such clauses in the articles of association do seriously curtail the right of free transfer but it is not necessary to go that length. As already pointed out a member of a public company is only authorised to transfer his shares in the manner laid down by the articles and if the articles do give the directors a power to control the entry of strangers to the company by holding up registration the same operates as a restriction on transfer. On behalf of the assessee reliance was placed on certain authorities both English and Indian to show that when the seller of the shares fulfilled his part of the bargain by handing over the share scrip with a properly executed deed of transfer his duty was at an end and the transfer so far as he was concerned was complete. I do not think that the authorities go as far as that. In *London Founders Association Ltd. v. Clarke*, the plaintiff company (association) had purchased through a broker and subject to the rules of the London Stock Exchange certain shares in a company (the National Conservative Industrial Dwellings Association Ltd.), from the defendant. The articles of association of the last mentioned company gave the directors the right to decline to admit as a member any person claiming by a transfer of shares. The directors of the company refused to register the plaintiff as transferee of the shares whereupon an action was brought for recovery of the price paid. It was held both by the trial court and the Court of Appeal that the action was not maintainable. It was contended on behalf of the plaintiff that there was an implied term of the contract by way of conditions subsequent that if the company for any reason refused to register the transfer the contract should be considered as at an end and the price would be recoverable on the ground of a total failure of consideration. This was negatived by all the learned judges of the Court of Appeal and Lord Esher M. R. observed at page 582 :

"I have no doubt that the seller must not prevent or do anything to prevent the company from accepting the purchaser or his nominee. What the remedy would be, if he did, it is unnecessary now to consider. There is nothing here to shew that the seller in this case did anything of the kind. I do not think anything turns on the fact that by the articles of association the directors had an option to decline to register the proposed transferee. If they had no such option and wrongfully refused to register the transfer, it seems to me the same considerations would apply. The purchaser in that case, it is true, might have a remedy against the company, but I do not think that the vendor does undertake that the company will accept the purchaser so as to make himself responsible for their refusal to do so. The purchaser takes that risk on himself, and the seller's liability is satisfied by handing to the purchaser the transfer and certificates of the shares in proper form, and doing nothing either before or subsequently to prevent the registration of the purchaser."

In my view, these observations do not mean that the transfer is complete on execution of the transfer deed and the handing over of the share scrip. As already pointed out so long as the purchaser's name is not entered on the register the transferor continues to be the only person whom the company can recognise as the owner of the shares. It is to him that all dividends must be sent and it is he who can appear at the meetings of the company and cast his vote. No doubt he will have to make over the dividend to the purchaser and vote as directed by the latter but still it is the alone whom the company will recognise. All that was said in *Moffat v. Farquhar* to which our attention was drawn is that the right to transfer shares in joint stock companies is a right of property and directors must not arbitrarily or capriciously refuse to register the name of the purchaser so as to prevent transfers being effected. In *P. V. Rama Reddy v. Padampat Singhania Chagla* C.J. observed "a shareholder who has sold his shares and continues to be on the register of the company is a constructive trustee for the purchaser of these shares with regard to the dividends that he receives on the shares and that he is also bound to carry out the directions of the purchaser with regard to any voting that might take place at any meeting of the company." This observation does not carry the matter any further than the English authorities cited.

In *Firm Sawan Mal-Gopi Chand v. Shiv Charan Das*, the plaintiff firm sold twenty shares of the Lahore Bank Ltd. worth 2,000 to Shiv Charan Das on September 12 or 13, 1913. The firm had only paid Rs. 100 to the bank on account of the shares and sold the shares for Rs. 80 only. A deed of transfer was duly executed and signed by the parties and was made over to Shiv Charan Das to enable him to have his name registered in the book of the bank. In November, 1913, the bank went into liquidation before the transferee had presented his deed of transfer and the shares continued to stand in the name of the firm as before. In October, 1916, the firm brought a suit against Shiv Charan Das for recovery of Rs. 80 as price of the shares sold. The trial court held that the transfer of shares was not complete because it required the sanction of the bank. The plaintiff's appeal to the District Judge was unsuccessful. Before the High Court the only point in dispute was whether in the eye of the law this transfer amounted to a complete transaction binding on the parties or not. On behalf of the defendant stress was laid on articles 28 and 29 of the articles of association of the bank which gave the directors a power to decline to register a transfer of shares without assigning any reason therefor in which case the transferor was to be deemed to remain a holder of the shares until the name of the transferee was entered on the register. It was argued that in the circumstances it could not be said that the ownership of the shares had passed to the defendant merely because the transfer had been executed. The Division Bench of the Lahore High Court concluded that as the defendant never presented the transfer for registration and as the bank had never refused to register the shares the defendant should not be allowed to take advantage of his own omission to avoid the contract. The learned judges observed : "We hold that the contract was complete on the day that the deed of transfer was signed by both parties and that by virtue of that the defendant stepped into the shoes of the

transferor and became and owner of the twenty shares in the company in his place, with all the advantages and disadvantages attached to that status." Reliance was placed on this observation in support of the contention that as soon as the transfer is executed in proper form the transferee becomes the owner of the shares. This statement of the law taken apart from the context is not quite accurate. So far as the transferor is concerned it may be that he has carried out his part of the obligation under the contract to sell the shares but the legal ownership continues in him so long as the transfer is not registered and, although in one sense the shares may be said to belong to the transferee, in that he holds the beneficial interest therein, the legal title still continues in the transferor. If and when the transferee seeks to sell the shares he will have to ask the transferor to execute a deed of transfer in favour of the new purchaser as he himself cannot execute any deed of transfer.

Therefore, in considering whether the shares of the assessee company are freely transferable one cannot lose sight of the fact that the directors have the unqualified right to reject any transfer and the mere fact that they have not so far objected to any transfer placed before them does not mean that they cannot use the power given to them by article 39 of the articles of association of the assessee company. The question referred to us must therefore be answered in the negative. The assessee must pay the costs of this reference.

RAY J. - I agree.

Question answered in the negative.