

BOMBAY HIGH COURT

Raghuvanshi Mills Ltd

Vs.

Commissioner of Income Tax

Income-tax Reference No. 37 of 1952

(Chagla, C.J. and Tendolkar, J.)

10.03.1953

JUDGMENT

Chagla, C.J.

1. The question that arises on this reference is whether the assessee company is entitled to the benefit of the third proviso to Section 23A, Income-tax Act, which provides that Sub-Section (1) of Section 23A shall not apply to any company in which the public are substantially interested.

2. The assessee company has a subscribed capital of Rs. 10,00,000 divided into 10,000 shares of Rs. 100 each, and during the relevant accounting period, which is the assessment year 1943-44, the company had eight directors who held between them 4695 shares. One of the directors was one Maganlal Prabhudas who held 1344 shares and his two sons Ravindra Maganlal and Surendra Maganlal were also directors who held each 1168 and 1100 shares. 4754 shares were held by various relations of the directors and 1,000 shares each were held by three other sons of Maganlal, viz. Bipinchandra, Harishchandra and Krishnakumar, and the balance of 551 shares were held by members of the public unconnected with the directors of the assessee company. There is an Explanation to the third proviso to Section 23A, and to the extent that it is material it reads as follows :

"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 25 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."

The question that the Tribunal had to consider was whether 25 per cent. of the shares of the assessee company were held by the public within the meaning of this Explanation, and in order to decide that question the only material issue that arose before the Tribunal was whether the

3,000 shares held by Bipinchandra, Harishchandra and Krishnakumar could be considered to be shares held by the public.

3. In order to decide this question we have to consider what is the proper meaning to be given to the expression "held by the public" used in the Explanation. There can be no doubt that the expression "public" is used in contradistinction to the directors and the whole object of the third proviso is that there must be voting power exercised which must be independent of the control of the directors, and the Legislature has taken the view that the public would be deemed to be substantially interested in the company if 25 per cent. of the shares are held by members of the public. Therefore, what is emphasized in the proviso is that the public should not only be interested, but should be substantially interested and the interest of the public would only arise if the public can exercise an independent control over the affairs of the company. But if members of the public who are shareholders are under the control of the directors and if their voting power is controlled by the directors and if the votes cast by them are not their own votes but in substance the votes of the directors, then for the purpose of this proviso the shares in effect are not held by the public at all but are held by the directors. It is from this point of view that one must approach the correct meaning to be given to the expression "public". Mr. Palkhivala says that we must give to the expression "public" its ordinary natural meaning. In our opinion that contention is entirely untenable. If that were the correct interpretation, then a director is as much a member of the public as anyone else, but it is conceded by Mr. Palkhivala that in considering who the public is the directors must be excluded. Now, why are the directors excluded? They are excluded because being in control and management of the company they are interested in the company and they would take a point of view which would be a partisan view. But the Legislature wanted, a point of view which was an independent point of view and therefore it would not be correct to Interpret the expression "public" in its larger and wider sense or connotation.

4. There is a very interesting decision of the English Court reported in - *Tatem Steam Navigation Co., Ltd. v. Commrs. of Inland Revenue*¹. The English law on the subject is slightly different from our law. In order that an assessee company should be subjected to the provisions of Section 23A under our law it is necessary that the public should not be substantially interested. Under the English law one further condition is necessary and that is that it should not be controlled by more than five persons, and the English decision to which we are about to refer must be appreciated in the light of this additional condition which is present in the corresponding English section. In that particular case 16,000 shares of the assessee company were transferred by Lord Glanely, who was a director of that assessee company, to his niece as a personal gift and she in her turn settled those shares upon the trusts of her marriage settlement, and the question that arose was whether the niece was a member of the public within the meaning of the section. In the judgment of Lawrence, J. there is a passage on which Mr. Palkhivala has placed strong reliance, and that is that the word "public" must not be read in any different sense from the ordinary meaning of the word. But Lawrence, J. goes on to observe that he can derive some light from the other

provisions of the section as to what the Legislature intended to mean by the word "public", and he points out that when the Legislature is dealing with the other condition about the company being controlled by more than five persons it includes relatives or nominees of those persons, and the expression "relative" is denned in the statute and it is defined as a husband or wife, ancestor, or lineal descendant, brother or sister, and Lawrence, J. makes a definite point of the fact that in the definition of the expression "relative", niece is not included and therefore he comes to the conclusion that

¹(1941) 24 Tax Cas 57

if a niece of a director could not be considered to be in a position to control the company, equally so from the point of view of control she could not be considered to be a member of the public. When the matter went in appeal, Scott, L.J. enunciates with respect the correct principle of law, and that is that if there is a 'de facto' control over a shareholder by a director of the company, then the shareholder cannot be deemed to be a member of the public as he has no independent voting right, and the learned Lord Justice points out at p. 67 that in that particular case there was no suggestion and no evidence and no finding that Lord Glanely had in fact any control over his niece. He further points out that implication, of control is raised by the statutory presumption in the case of husband and wife, ancestor, lineal descendant, brother and sister, but in the case of no others (p. 67) :

"Consequently" the learned Lord Justice adds, "we must regard a person in the position of a niece as being treated by the Statute as a member of the public. The Statute contains no prohibition against avuncular generosity, any more than against generosity to a person between whom and the donor there is no consanguinity or relationship at all."

Therefore, the Appeal Court rejected the contention that the mere fact that the uncle had made a gift of the shares to the niece raised a presumption of control by the uncle over the niece.

5. Now, in India, there is no statutory presumption as to control. Therefore, as far as our law is concerned, in each particular case it must be found as a fact that a director exercises 'de facto' control over a shareholder. If that is found as a fact, then that particular shareholder for the purposes of Section 23A will not be considered as a member of the public. It is from this point of view that we must consider the statement of the case submitted to us, and the question raised for our decision.

6. Now, in the order the accountant member with respect, has approached the matter from a point of view which seems to us to be not quite correct. The view he takes is that when you have a managing agency given to a limited company, then every shareholder of that limited company is under the control of the directors of the managed company. This opinion of the accountant member has been formed on certain facts which still remain to be stated. On 7-5-1942, the assessee company appointed Ravindra Maganlal and Co., Ltd., as its managing agents. The total issued and subscribed capital of this private limited company was a sum of Rs. 5,000 and Rs.

1,000 each was subscribed by the five sons of Maganlal Prabhudas, viz., Ravindra, Surendra, Bipinchandra, Harishchandra and Krishnakumar. It is important to note that of these five shareholders, as already pointed out, Ravindra and Surendra were directors of the managed company and Ravindra, Surendra and Bipinchandra were directors of the managing agency company, and it is in the light of these facts that the accountant member had to consider the principle that he should apply, and, as already pointed out, the principle that he enunciated was a general principle that in the case of every managing agency company the shareholders are controlled by the directors of the managed company and the shareholders cannot be considered to be members of the public. In our opinion that, standing by itself, is much too wide a proposition. You may have a managing agency company in which the shareholders may have no relationship with the directors of the managed company, and it would not be correct to say from the mere fact that there is a managing agency company that the shareholders of that company must necessarily be under the control of the directors of the managed company.

7. The accountant member has also enunciated another proposition of law which again with respect, seems to us to be incorrect. What he says is that any person connected with the business of the assessee company or anyone who derives personal benefit out of that business of the assessee company is under the control of the directors. That again is much too wide a proposition. What has got to be found is not the mere possibility of control, but actual control. We realise the difficulty of having direct evidence of control exercised by a director over a shareholder. But there would always be facts and circumstances in each case from which it would be possible to draw the inference that there was actual 'de facto' control by directors or a director over a shareholder or shareholders, and if in this particular case the Tribunal had found as a fact that looking to all the circumstances of the case the directors of the assessee company exercised 'de facto' control over these three shareholders, then we would have accepted that finding without demur. But there is no clear or definite finding of the Tribunal on this point. The finding is based upon a proposition of law which, as already pointed out, is not correctly stated. When we turn to the decision of the Judicial Member, he takes the view that the three shareholders in question in this case are mere nominees of the controlling shareholders of the assessee company. If they are, he says they cannot be regarded as members of the public. Now, this may be looked upon as a finding of fact that these shareholders are under the control of the directors of the assessee company. But in the very next sentence he says :

"I think the shareholders are nominees whose voting power may be controlled". As we have already pointed out, the mere possibility of the voting power being controlled is not enough. Anything is possible and anyone's voting power may be controlled, but that is not what the law requires. The law requires a 'de facto' control, a control which is in fact exercised, and here again we do not find that the Judicial Member has given that finding.

8. We, therefore, find ourselves in this difficulty that it is not possible for us to answer either the question which we ourselves had directed the Tribunal to raise or which the Tribunal suggests

should be raised, unless we have got the necessary facts from the point of view of the correct principle of law which we have just enunciated. It is only when we get those facts that we would be in a position to answer whether on the facts and circumstances of the case the provisions of Section 23A, Income-tax Act are applicable to the assessee company, or whether on the facts and circumstances of the case, 1000 shares each held by Bipinchandra, Harishchandra and Kishnakumar 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 Section 23A.

9. We would, therefore, direct the Tribunal to submit to us a supplementary statement of the case in the light of our judgment. In preparing the supplementary statement of the case, the Tribunal will give liberty both to the assessee company and to the Commissioner to lead any further evidence if either of them is so advised, and after considering the materials already on record and any fresh evidence that might be led by either party, they will submit a supplementary statement to enable us to answer the question that has been raised.

Order accordingly.