BOMBAY HIGH COURT

Jubilee Mills Ltd

Vs.

Commissioner of Income-Tax

Income-tax Ref. No. 40 of 1957

(Chagla, C.J. and S.T. Desai, J.)

13.03.1958

JUDGMENT

Chagla, C.J.

1.The main question that arises for our decision on this reference is whether the assessee company is a company to which Section 23A applies. The facts briefly are that the share-capital of the company consisted of 1 lakh Ordinary Shares of Rs. 10/- each aggregating to Rs. 10,00,000/-, 5,000 Cumulative Preference Shares of Rs. 25/- each aggregating to Rs. 1,25,000/- and 4,000 Second Preference Shares of Rs. 100/- each aggregating to Rs. 4,00,000/-. All the shares were fully paid up.

2. Now, under Section 23A what has got to be considered is the voting power and it is clear from the provisions of Section 23A, as it stood at the relevant date, that the only shares that we have to consider are the Ordinary Shares. The position with regard to the Ordinary Shares was this. Seven Directors between themselves held 35,469 Ordinary Shares. These Directors were also partners in the managing agency firm of Mangaldas Mehta and Co. which managed the assessee company. The managing agency firm consisted of 14 partners, seven of them being the Directors and the other seven partners held between them 41.859 Ordinary Shares. 9,899 Ordinary Shares were held by persons who were represented by the Directors either as Kartas or as guardians. 75 shares were held by the firm of Girdhardas and Co. Ltd., which is a company to which the provisions of Section 23A are applicable. The question that fell for determination by the Tribunal was whether on these facts it could be said that the company was a company in which the public were substantially interested. If the public were substantially interested, then Section 23A had no application.

3. The expression "the public are substantially interested" has been defined in Section 23A and that is to be found in the Explanation to Sub-Section (1), which provides :

> "a company shall be deemed to be n company in which the public are substantially interested if shares of the company (not being shares entitled to n 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 have been allotted unconditionally to, or acquired unconditionally by and are at the end of the previous year beneficially held by the public (not including a company to which the provisions of this sub-section apply) ....."

Therefore, under this Explanation what is required is that the public must hold shares which carry with them at least 25 per cent, of the voting power; and if the Department satisfies us that on the facts in the statement of the case it is established that the voting power, controlled by the public is less than 25 per cent., then the Department is entitled to apply Section 23A to the assessee company.

4. We may notice in passing a contention put forward by Mr. Palkhivala which seems to us to be not very substantial and that is that the Income-tax Officer in the first instance gave a rebate of one anna on the amount of income-tax which the company was liable to pay under the provisions of the Finance Act of 1948 and Mr. Palkhivala says that this rebate could only be granted to a company to which Section 23A had no application and Mr. Palkhivala urges that in granting this rebate the Income-tax Officer came to the conclusion that Section 23A had no application and having once come to that conclusion it is not open to him subsequently to revise his conclusion and arrive at a contrary conclusion that Section 23A should be applied to this company. Now, when we turn to the Finance Act of 1948, all that is required in order to entitle a company to the rebate, apart from other factors with which we are not concerned on this reference, is that no order has been made under Sub-Section (1) of Section 23A. Therefore, this is a factual condition and when the I. T. O. made the assessment order in fact no order under Section 23A had been made and therefore he was competent to grant the rebate to the assessee company which he did. After the assessment order was made he applied his mind to all the materials which were placed before him and came to the conclusion that Section 23A was applicable. There is nothing in law to prevent the I. T. O., after the assessment order has been made, to apply Section 23A to an assessee company. As a matter of fact, it is only after the assessment order is passed that the question of applying Section 23A can arise.

5. Now turning to the more substantial contention, could it be said on the facts established that the public did not have voting power to the extent of 25 per cent ? The contention of the Department broadly is - which contention seems to have been accepted by the Tribunal - that we have here a group of shareholders who constitute the managing agency firm and this group between themselves hold 77,128 shares out of 1,00,000 shares. Therefore, it is clear that the public share-holding is less than 25 per cent. From this point of view it is unnecessary to consider the question with regard to the 9.899 shares or the 75 shares or any other shares, because if the view taken by the Department or the Tribunal is sound, then it is sufficient to dispose of this question on a mere consideration of the fact that you have a company here managed by a managing agency firm the partners of which between them hold more than 75 per cent, of the voting power of the shares.

6. Now this is not a matter which is res integra. An almost identical question came up for consideration before this Court and the Court clearly laid down what constituted "the public" and under what circumstances it could be said that certain shareholders were or were not members of the public. We had to consider this question in *Raghuvanshi Mills Ltd. v. Commissioner of*

Income Tax[1], We have this similarity between the case here and

[1]1953-24 ITR 338

the case of Raghuvanshi Mills, that in Raghuvanshi Mills case there was a limited company which was acting as the managing agents and the question was whether the shareholders of the company were under the control of the Directors of the managed company. Now the principle we laid down was that there was a contra-distinction between the Directors and the members of the public and our view was that, inasmuch as the Directors controlled the voting power, the Directors could not be looked upon as members of the public. We further pointed out that if any share-holder was actually controlled by a Director as far as that shareholder's voting power was concerned, then that shareholder could not be looked upon as a member of the public. Therefore, really we defined three categories. In the first place, Directors, according to us, were per se outside the public because they controlled the company and our view was that the, public contemplated by Section 23A must be independent of the control of the Directors. The second category consisted of those who prima facie were members of the public but who could be proved by the Department to be not members of the public if they established that in fact their voting power was controlled by the Directors. The third category would be the category consisting of shareholders who belong to the public who were neither Directors nor persons whose votes were controlled by the Directors. We were at pains to point out that the Tribunal was wrong in assuming that the mere fact that a shareholder was a part of any group that acted as managing agents of the managed company or had any connection with the managing agency necessarily implied that he had his vote controlled by the Directors. We further emphasized the fact that mere possibility of control was not sufficient : what was to be established was actual control. Under those circumstances, in Raghuvanshi Mills' case, we sent the matter back to the Tribunal to find the necessary facts to establish that the shareholders, who were members of the limited company which managed the assessee company, were controlled by the Directors in the sense that they did not exercise their votes independently but under the control of or at the dictates of the Directors.

7. The law, therefore, was clearly laid down; and we make bold to say that there was no ambiguity as to what we had decided. It is surprising that, notwithstanding this decision, in the first place, the Department should have taken a view which is diametrically opposed to what we have decided. Instead of trying to establish by evidence, either direct or indirect, that the members of the managing agency firm other than the Directors were, controlled by the Directors, the Department merely relied on a legal principle that, because the managing agents managed the company and because seven of the partners of the managing agency firm were Directors of the company, therefore necessarily the other partners of the managing agency firm were controlled by the Directors. This is exactly the proposition which we had emphatically rejected in Raghuvanshi Mills' case. What surprises us more is that the Tribunal, before whom this decision was cited, has again decided on a principle which appeared to us in Raghuvanshi Mills' case to be erroneous. This seems to us to be the ratio of their decision :

> "The group of 14 individuals collectively constitute this firm called Mangaldas Mehta and Co., which was under a contractual obligation to manage the company and. therefore, they constitute a juristic person. That juristic person holds more than 75 per cent, of shares. The Managing Agents have special rights, privileges and responsibilities and, therefore, have to be taken as a unit. For instance, the Managing Agents, as such, have to

appoint certain Directors and those Directors have to act according to the directions of the Managing Agents. This, in our opinion, is a point strong enough to show that the group as a whole has to be taken in determining where the controlling power vests."

Now we are not concerned with the control or management of the company; we are not concerned with the fact which is obvious to any one that the managing agents act under the directions of the Directors as far as the management of the company is concerned. For the purpose of Section 23A what is relevant and pertinent is not the administrative management of the company, but the voting power and it may well be - though it may be a very rare phenomenon - that a partner in the managing agency firm, although he may be bound to carry out the orders of the Directors as far as the management of the company is concerned, may have sufficient independence, integrity and conscience to vote according to his own lights and not according to the lights of the Directors. Now, the matter was a little complicated - we must say in fairness to the Tribunal - before it by reason of the fact that subsequent to our decision there was a decision of the Privy Council which, in certain respects seems to have taken a different view from the view we took in Raghuvanshi Mills' case. Before we take up the Privy Council's decision we should like to say this. No Bench could have greater respect for the decision of the Privy Council even after 1950 than we have. But the position after 1950, as far as the Privy Council is concerned, is different from the position which it occupied before 1950. Before 1950 the law laid down by the Privy Council was the law of the country. After 1950 the Privy Council's decisions are only of a persuasive authority : The only final tribunal which can lay down the law in this country is the Supreme Court; and if the Supreme Court has not laid down the law, then the final authority in this State is the High Court of Bombay; and it was not open to the Tribunal to consider the decision of the Privy Council if it was at variance with our decision, but to follow our decision till the Supreme Court laid down the correct principle.

8. But even when we turn to the Privy Council decision, it is difficult to understand the decision of the Tribunal. The main difference between the decision of the Privy Council and the decision in Raghuvanshi Mills' case is this. Whereas the distinction that we drew was between the Directors and the public, the Privy Council drew the distinction between controlling interest and the public. We said that "the public" contemplated by Section 23A is the public which is independent of the Directors. What the Privy Council said was that the public contemplated was the public which was in contra-distinction to that element among the shareholders which had the controlling interest of the company, and, according to the Privy Council, if a shareholder had 51 per cent, interest, he had the controlling interest and anybody else who was not controlled by that shareholder was a member of the public. The Privy Council went further and said that, in order to establish that some other shareholder or shareholders were not members of the public, what would have to be established was that that shareholder or shareholders acted in concert with the shareholder who had the controlling interest. But it must be remembered that the case which the Privy Council was considering in *Commissioner of Income Tax v. Bjordal*[2], was rather a peculiar case. It was a case of two brothers, one brother holding about 75 per cent, of the shareholding and the other brother holding more than 25 per cent. Between the two brothers they held about 99 per cent, of the shareholding and the question was whether the fact that the other brother held more than 25 per cent, of the shares constituted the company a company in which the public was substantially interested; and

[2]1955-28 ITR 25

the Privy Council said that it was, because only the brother who held 50 per cent, should be excluded from the consideration whether the shareholder belonged to the public or not and unless it was shown that the brother who held more than 25 per cent, acted in concert with his other brother the Court could not draw the conclusion that, because both the brothers held between them 99 per cent, of the shares, therefore the public-was not substantially interested. Now, it is significant to note that both the brothers were Directors and notwithstanding that fact, the Privy Council held that the company was a company in which the public was substantially interested. At page 35 their Lordships say :

> "The appellant also argued that neither the respondent (that is the brother who held the controlling interest) nor Severe (that is the other brother) could be regarded as members of 'the public' as they were directors of the company. It is clear that members of 'the public' within the meaning of the section are shareholders in the company. Their Lordships can find no reason for holding that shareholders cease to be members of 'the public' because they have become directors."

Therefore, this view is opposed to the view we took in Raghuvanshi Mills' case. It may be pointed out that in that case council for the assessee conceded that in considering who the public is the directors must be excluded. But the Privy Council makes it clear on the same page that they were not deciding a case of group of persons holding shares which would constitute a controlling interest over the company and this is what their Lordships say :

> "It was said in the course of the argument that if the requisite percentage of voting power is not held by one individual but held by more than one individual, a controlling interest cannot be said to arise unless it is shown that the individuals who together hold the requisite percentage are acting in concert. In the case before their Lordships over 51 per cent, of the voting power was held by the respondent, a single individual and consequently the question does not arise. Their Lordships express no opinion upon the questions which would arise when the requisite percentage is not held by a single individual but only by a group, or by overlapping groups, of individuals."

Therefore, in essence Mr. Palkhivala is right, that to the extent that the Privy Council decides that Directors must be considered as members of the public, the decision helps him and the shares held by the Directors cannot be considered per se to be held by persons who are not members of the public. But the Privy Council decision is relied upon by the Tribunal for a different purpose and the view that they have taken is that, just as in the Privy Council case the Director with the controlling interest was held to be a shareholder not belonging to the public, so here the managing agency firm, inasmuch as it holds more than 75 per cent, shares, must be held to have the controlling interest in the company, and, therefore, the whole of that group should be excluded from the public. Now, in the first place, the Privy Council had not decided this point; and, in the second place, the view taken by the Tribunal, as already pointed out is opposed to the view taken in Raghuvanshi Mills' case. 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. But, as we have said, so long as the judgment of the Bombay High Court stands, it was the duty both of, the Department and of the Tribunal to give effect to that decision.

9. It is urged by Mr. Joshi, who realises that the Department has not acted with its usual efficiency and competency in this case, that we should order a remand. Now, "remand" is not the exact word that is, appropriate in income-tax references. All that we can do is to call for a supplemental view of the case under Section 66(4). Mr. Joshi says that, just as in Raghuvanshi Mills' case we asked the Tribunal to find the necessary facts, we should do the same in this case. In our opinion, the position today is entirely different from the position that existed when we were called upon to decide Raghuvanshi Mills' case. The law then was not settled. As far as we know, that was the first case of its kind that arose here and we were only guided by some English cases which were not strictly pari materia because the English law is different from our law under Section 23A. Under those circumstances, we felt that the Department could not be blamed if it had not established the proper facts in order to bring the company within the purview of Section 23A. How can it be said today that the Department should be given the indulgence which was given to it in Raghuvanshi Mills' case ? Knowing what it had to prove and establish, it has made no efforts to adduce any evidence to prove that the voting power of the shareholders, who constitute the partners of the managing agency firm other than the Directors, were controlled as far as their votes were concerned by the Directors. Mr. Palkhivala is right when he says that, if we were to accede to the application of the Department, we will really permit the Department to have a second innings. Our attention has also been drawn to what the House of Lords said in *Fattorini Ltd. v. Inland Revenue Commrs*[3]*.,* at page 60. that this was a "highly penal" section; and the consequences of applying Section 23A undoubtedly are very serious. If, therefore, the Department with the knowledge of the law with the knowledge of what facts have to be established and what evidence has to be led, does not choose to do so, it cannot at the reference stage ask this Court to call for a supplemental statement of the case in order to permit it to make up the lacuna which exists in the case and make Section 23A applicable to the assessee. Section 66(4) strictly applies when we find that we cannot dispose of a reference in the absence of additional facts. Now the question that we have to decide is whether, on the facts and in the circumstances of the case, the assessee company is a company in which the public are substantially interested for the purposes of Section 23A of the Act and on the facts and circumstances which appear from the statement of the case we have no difficulty in holding that, in view of the fact that 41,659 out of 1,00,000 shares are held by seven shareholders who are not Directors and who are not proved to be under the control of the Directors, the assessee company is a company in which the public are substantially interested. Therefore, no case has been triads out for our calling for a supplemental statement of the case.

10. Our attention was also drawn by Mr. Palkhivala to a decision of the Supreme Court in *Commissioner of Income Tax v. Benoy Kumar Sahas Roy*[4]*,* There too the income-tax authorities failed to adduce proper evidence to establish whether the income was agricultural or non-agricultural income and an attempt was made before the Supreme Court to send the matter back to enable the Department to conduct the proper enquiry. That application was rejected by The Supreme Court by pointing out that, in view of the long lapse of time, it did not consider it desirable to direct any such enquiry. The same consideration would also apply here because the assessment year with which we are concerned is 1948-49 and we are now in 1958.

[3]1943-11 ITR (Sup) 50

[4]1957-32 ITR 466 : AIR 1957 SC 768

11. The result is, we must answer :

Question No. (1) : In the affirmative.

Question No. (2) : In the affirmative.

Question No. (3) : Unnecessary in view of our decision on question No. (2).

12. Commissioner to pay three-fourths of the costs of the reference.

Answers accordingly.