BOMBAY HIGH COURT

Raghuvanshi Mills Ltd

Vs

Commissioner of Income-Tax

(S Kotwal, C.J. V Desai, J.)

11.03.1969

JUDGMENT

V.S. Desai, J.

1. The question, which has been referred on this reference under section 66 (2) of the India Income-tax Act, 1922 is :

> "Whether on the facts and circumstances of the case, the provision of section 23A of the India Income-tax Act, 1922 (XI of 1922], are applicable to the petitioners ?"

2. The assessee is public limited company incorporated on the 28th of February, 1929. During the account year of the assessee company, viz., April 1, 1942 to March 31, 1943 for which the relevant assessment year was 1943-44, the divided declared by the company in its annual general meeting was less than what was required under section 23A of the Income-tax Act, 1922. A question, therefore, arose whether the assessee-company was one to which the provisions of the said section were applicable.

3. Now, the company's issued and subscribed capital contended of 10,000 shares, of Rs. 100 each. During the relevant accounting period, 4,695 of the share were held by the 8 directs of the assessee-company together including amongst them Maganlal Prabhudas and his two sons, Ravindra Maganlal and Surendra Maganlal, their shareholdings being :

Maganlal Prabhudas	1,344 shares
Ravindra Maganlal	1,168 "
Surendra Maganlal	1,100 "

4,754 shares were held by the relations of the director including three other sons of Maganlal Prabhudas, viz., Bipinchandra Maganlal, Harischandra Maganlal and Krishnakumar Maganlal and his wife, Kantabai Maganlal. Each of the three sons held 1,000 shares and the wife held 771

shares. The remaining 551 shares we held by the members of the public. During the material time, Ravindra Maganlal & Co. which was a private limited company, was to managing agents of the assessee-company. The issued and subscribed capital of this private limited company Rs. 5,000, which was equally subscribed by the five sons of Maganlal Prabhudas. The directors of the managing agency company were Ravindra Maganlal Surendra Maganlal and Bipinchandra Maganlal, the first two of him were also the directors of the assessee company. Now, under section 23A, as it stood at the material time, companies in which the public are substantially interested were excluded from the operation of the section and a company was to be demanded to be on in which the public are substantially interested were excluded from the operation of the section and a company was to be deemed to be one in which the public are substantially interest if shares carrying 25 per cent, or more of the voting power were held unconditionally and beneficial by the public and such share were during the previous year the subject of dealing in any stock exchange or were in fact freely transferable by the holders to the other members, of the public. According to the Income-tax Officer the shares held by the assessee's directors or by the relations of the directs could not be regarded as the share held by the public and since excluding these share only 551 shares qualified to be share held by the public, the pub; lie could not said to be holding share carrying voting over of at least 25 per cent. In his opinion, therefore the assessee-company could not be treated ads a company in which the public were substantially interest and consequently the provisions of section 23A were applicable to it. He according made an order under the said section against the assessee-company. The decision of the Income-tax officer was confirmed in appeal by the Appellate Assistant Commissioner, the decision taken by the department authorities as to the applicability of the provisions of section 23A to the assessee-company was affirmed but to the Income-tax Appellate Tribunal. In upholding the decision of the department authorities, one of the members of the Tribunal took the view that the shares held by the directors of the assessee-company and the shears held by the person interest in the managing agency could not be regarded as shares held by the public and since the total of those exceeded 75 per cent. off the total number of shares, the assessee-company could not be said to be one in which the public are substantially interested. According to the members of the Tribunal the shares held by the directors and the shows held by the relations of the director could not qualify as shares held by the members of the public. When the matter came to this court on a that in the case of every managing agency company the shareholders are controlled by the directors of the managed company in which the shareholders may have no relationship with the director of the managed company. The reason given by the Tribunal, therefore that the shares held by the persons interested in the managing agency had to be excluded because such persons were under the control of the directors of the managed company was not correct and what was required to be found was whether they were in facts so controlled. Similarly, merely because the shareholder was a relation of the director was not sufficient to make the shares held by the shareholders as

share not held by the public. Mere relationship was not sufficient but what was further required to be found was that the shareholding of the reliance was in the fact controlled by the director. This court, therefore, though it necessary top call for a further supplementary statment from the Tribunal in the light of its judgment. The Tribunal accordingly furnished a supplementary statement recording its finding that the shares held by the three sons of Maganlal Prabhudas, who were interested in the managing agency, were under the de facto control of their father, Maganlal Prabhudas dying the material time. On receipt of this supplementary statment from their Tribunal this court accepted the said finding. Now, it may be pointed out that in submitting its statement on the question framed by this could under section 66 (2) the Tribunal had pointed out that controversy between the parties mainly related to the quality of shares held by the three sons of Maganlal Prabhudas viz., Bipinchandra Maganlal, Harishchandra Maganlal and Krishnakumar Maganlal, who were interested in the managing agency along with the other two sons, whom were also the director of the assessee-company. It had, therefore while submitting the statement of case, observed that the more appropriate question for reference was :

> "Whether, on the facts and circumstance of the case, 1,000 shares each held by Bipinchandra Maganlal, Harishchandra Maganlal and Krishnakumar Maganlal in the capital of there assessee-company are held by members of the public within the meaning of the Explanation to the third proviso the section 23A ?"

4. This court after having accepting the Tribunal finding with regard to the shares held by the said three sons of Maganlal Prabhudas also agreed to reference the question as suggested by the Tribunal and answered it in the reform the question suggested by the Tribunal and answered sit in the reaffirmed from in the negative. The assessee went in appeal to the Supreme Court against the decision of this court. The decision of the Supreme Court is Raghuvansi Mills Ltd. v. Commissioner of Income-tax. The Supreme Court had that this court had erred in proceeding on the footing that the shoes held by the Director could never qualify to be share held by members of the public. Similarly, the mere relationship was not sufficient and of no consequence unless control of the voting power held by the relative was proved. It point out that in order to find out the shares held by the public, it was necessary to find out whether there was an individual or a group with controlled the voting power as a block. If there was such a block, the shares held by it could not be said to be unconditionally and beneficially held by the members of the public. In the category of shares held by the public, only those shares could be counted which were unconditionally and beneficially held by the public, or, in other words, which were uncontrolled by the group which controlled the affairs of the company. The group itself might be composed of directors or their relations nominees in different companies, but none could nee said to belong to that unconditionally and beneficial for himself. According to the Supreme Court, therefore, since the view taken by the High Court that the shares held by the directors could not be cede to be

shares had by the members of the public was erroneous on the mere finding that Maganlal Prabhudas, controlled the shareholding of his three sons, Bipinchandra Maganlal, Harischandra Maganlal and Krishnakumar Maganlal the applicability of section 23A of the assessee-company could not be sustained since the total shareholding of Maganlal Prabhudas and his three sons would together come to 4,344 shares only. In order to decided whether section 23A could properly be applied to the assessee-company or not, what was required were beneficially held by the public. The Supreme Court accordingly allowed the appeal set aside the judgment and order of this court and remanded the matter back to this court to decide the question as had been originally framed viz., "whether on the facts and the circumstances of the case, the provisions of section 23A of the Indian Income-tax Act (XI of 1922) are applicable to the petitioners ?"

5. When the reference came back on remand, this court called for a further supplementary statement from the Income-tax Appellate Tribunal on the question whether more than 75 per cent. Shares of the applicant were not beneficially held by the public in the light of there judgment of the Supreme Court. The Tribunal after calling for rapports from the department authorities submitted the further supplementary statement of the case required from it recording its conclusion that only 7,383 shares could be regarded a as held by a group consisting of Maganlal Prabhudas, his five sons and his wife, and the rest of the shares should be treated as held by the public. According to this fining of the Tribunal more the 25 per cent. of the shares could be said to be held by the public within the meaning of the Explanation On receipt of this supplementary statement this court heard the reference again on 2nd April, 1964, and accepted the finding of the Tribunal. It was, however argued before this court that, although share carrying more than 25 per cent for the voting power were held by the public, the assessee-company could not still be regarded as a company in which the public, the assessee-company could not still be regarded as a company in which the public were substantially interest because the other condition, viz., that its share must be the subject of framing on the stock exchange or must have been in fact freely transferable by the holders thereof to the other members of the public, was not satisfied. Admittedly, the share of the assessee-company were not listed on the stock exchange at the material time. The assays-company had always asserted that its shoes were freely transferable. It was however, contended on behalf of the department that in view of article 55 of the articles of association of the assessee-company, the directors had an absolute and uncontrolled discretion without assigning any reason to decline to registered any transfer of the and that amounted to a restriction on the transfer of shares and they could not, therefore be said to be freely transferable. There was considerable controversy before this court on the question as to whether the said contention was permissible to be raised by the department as arising on the order of the Tribunal. This court took the view that the department would be entitled to raise the said contention. It however, found that, although the contention a rose on the order Tribunal, the Tribunal had not applied its mind to it. This court, therefore, called upon the Tribunal to furnish a

further supplementary recording its conclusion in respect of this contention. The Tribunal accordingly has submitted a further supplementary statement requiring its conclusion in favour of the assessee that its shares are in fact freely transferable by the holders thereof to the other member of the public. The assassin the meanwhile had gone to the Supreme Court in an appeal the order of this court calling for this further supplementary. It has, however, withdrawn the said appeal reserving to itself the liberty to raised the question as to whether the point on which the supplementary statement was called for arose on the Tribunal's order.

6. Along with the supplementary statement the Tribunal has furnished a list of transfers effected from 1929 to 1963, i.e., from the incorporation of the assessee-company up to date and a perusal of his list will show that there have been transfer of the shares by some members of the public, transfers from the directors to the members of the public and from the members of the public to directors also some transfers between the directors themselves. In the affidavit, which was submitted by the chairman of the board of director before the Appellate Assistant Commissioner on the 7th of March, 1963, it was averred that, ever since the inception of the assessee-company the board of director had ever refused to accept any transfer whatsoever excepts income solitary case in 1962, when the board was reluctantly compelled in the larger interest of the company, as a whole, to decline the transfer of five share in the name of the F. S. Wadia, by the brother of the chairman of the assessee-company. It would thus be clear that thee shares of the assessee-company have in fact been transferred without any difficulty or any objection being raised by the directors call along. It is, however, contended on behalf, of the department come to the conclusion that they are freely transferable. What is required to be found is whether there is or there is not total absence of any restriction in the articles of association of the company with regard to the transferability of the shares. Article 55 of the articles of association of the company, it is urged is in the nature of a restriction on the transferability decline to register any transfer amounts to a restriction on the free transferability of the shares. It is argued that the transfer of shares is not complete until the transferor's name is entered as a shareholder in the registered of the company. Consequently, a refusal by the directors to register the name of the transfer would come in the way of competition of the transfer and thus would amount to a fetter on the transfer. In support of this submission reliance is placed on a decision of the Calcutta High Court in Commissioner of Income-tax v. Tona Jute Co. Ltd., where it has been held that a public comply whose directors have absolute discretion to refuse to register the 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, and are not obliged to give any reason foe refusal to register. It not a company the shares of which are freely transferable to other members of the public within to manning of section 23A of the Income-tax Act.

7. Now, it may be pointed out that the article of association of the assessee-company do not

contain any restriction on the transfer of share by one shareholder to another such as to be fond, as for instance, in the articles of association of a private company. Article 55, to which refines has been, made, is not by itself a restriction on the transfer of shares by a shareholder to another shareholder. It only gives the power to the directs to refuse to acknowledge the transfer or to register the transfer. A free transferability of the shares is a normal feature of the public limited companies and the articles like 55 in the articles a of association in the assessee-company is to be found in the article of isooctane of nearly all public limited companies, As a matter of fact it is one of the standard articles of association prescribed under the Companies Act itself. The intention on providing such article in the article of association of a company, having regard to the normal feature of the company that it shares, are freely transferable, is not top affect the general transferability of the shares. Its purposes is to arm the director of to company with power to be exercise in special and exceptional cases where the transfer of share in certain isolated instances is found to be undesirable in the interest of the company. The existence of such power in the directors of the company, therefor, could not be taken to affect the general transferability of the shares and treat the company shares as no freely transferable. If it happens that the said power used by the director of a company in a manner as to affect the general transferability of the share by the power being invoked in unduly large number of cases so that transfer of the share of the company is not permitted except in a feel and isolated cases, the company's shares, though freely transferable under its article of association may not, in fact, be freely transferable. What is required to satisfy the condition under the Explanation to section 23A is that the shares must, in fact, be freely transferable. In our opinion, the correct meaning of the expression "freely transferable" is that the share in the first place be freely transferable, in the sense that there must not be any restriction contained in the articles of association restricting the general transferability of the share by a shareholder to another person. Secondly, this quality of the transferability of the share must not only be in name but the shares must beer transferable in truth also. In other words, the company in it course of conduct must have freely allowed the transfer of share without resorting to its power under article 55 except in few and exceptional circumstances and for extraordinary reasons.

8. In the present case there are no restriction in the articles of association interering with the free transfer of share by the shareholders to others. The power under article 55 has also not been used by the director of the assessee-company in such a manner as to create a fetter transferable. On the facts circumstances of the present case, therefore, there is no difficulty in holding that the share of the assessee company are in fact freely transferable by the holder thereof to the other manners of the public. The view that we taking minds support from a decision of the Madras High Court in East India Corporating Ltd. v. Commissioner of Income-tax which has disagreed with the Calcutta decision in Commissioner of Income-tax v. Tona Jute Co. Ltd. relied upon by the department, though not on precisely the same reasoning as we have adopted.

9. As we have already pointed out earlier this court has earlier held on the earlier occasion that the shares carrying more than 25 per cent. of the voting power are held by the public and in view of our finding now the its shares are also, in fact, freely transferable by the holders thereof to the other manners of the public, it must be held that the assessee-company is company in which the public the are substantially interested and is consequently outside the operation of section 23A (1) by reason of the third proviso thereto.

10. Our answer, therefore to the question as originally submitted by the Income-tax Appellate Tribunal in its first reference, which according to the Supreme Court judgment, was required to be decided by this court, is in the negative. The Commissioner, will pay the costs of the assessee of the reference through in the High Court.

11. Mr. Kolah for the assessee has also urged that the assessee is entitled to the costs of the appeal in the Supreme Court preferred by the assessee against the section of this court calling for the supplementary statement of the case when it heard the reference on the last occasion on 2nd April, 1964. He has invited out attention to the order passed by the Supreme Court which says : "Costs costs in the High Court".

12. Now that order was made by the Supreme Court on the assessee's request to allow it to withdrawn the appeal before the Supreme Court with liberty received to argue before this court at the hearing of the reference and in any appeal that might be failed before the Supreme Court against the order of the High Court that the question amount the application to the appellant-company of the last part of the Explanation to section 23A of the Income-tax Act, 1922 - as it stood before it was amended by the Fiance Act 2 of 1955 - was never raised before the Tribunal and did not arise out of the order of the Tribunal. The Supreme Court allowed the assessee liberty to argue the said question and in that context made the orders : "Costs costs in the High Court". Since in the appeal, which was withdrawn by the assessee, the assessee would no have been entitled to cost at all the order "Cost costs in the High Court" has reference only to the liberty allowed to the assessee to reargue the question before the High Court. Since that question has not been argued by the assessee befores this court, as indeed it could not be argued in view of the earlier decision of this court, we do not think that the assessee will be entitled to the costs of the Supreme Court in pursuance of the order the Supreme Court.