

PILANI INVESTMENT CORPORATION LTD.

v.

THE COMMISSIONER OF INCOME TAX (CENTRAL)

January 9, 1973

[P. JAGANMOHAN REDDY AND H. R. KHANNA, JJ.]

Income-tax Act (11 of 1922), s. 23A and Explanation—Memorandum and Articles of Association empowering directors to refuse to register transfer of shares without assigning any reason—If element of free transfer eliminated.

This Court, in *Shree Krishna Agency Ltd. v. C.I.T. (Central) Calcutta*, (1971) 82 I.T.R. 372, had held that in the absence of evidence to show that the directors had been exercising their power to decline to register any transfer of shares freely and had thus virtually eliminated the element of free transferability of the shares in the company, the mere existence of a power in the Memorandum and Articles of Association giving such a discretion could not be said to affect the free transferability of the shares as contemplated by the Explanation to s. 23A, of the Income-tax Act, 1972. [20GD-E]

In the present case, more than 75% of the shares of the assessee-company were held not by a group of partners but by two public companies in which the Tribunal found, the public were substantially interested; there was no material to show that any group acting in concert was in control of the assessee-company, and, though the Memorandum and Articles of Association gave a discretion to the directors to decline to register a transfer of shares, there was no evidence to show that the directors had eliminated the element of transferability of shares.

Shree Krishna Agency Ltd. v. Commissioner of Income-tax, (Central) Calcutta, [1971] 82 I.T.R. 372, followed

Commissioner of Income-tax, West Bengal v. Tona Jate Co. Ltd., [1963] 48 I.T.R. 902, overruled.

East India Corporation Ltd. v. Commissioner of Income-tax, [1966] 61 I.T.R. 16 and *Raghuvanshi Mills Ltd. v. Commissioner of Income-tax*, [1969] 74 I.T.R. 823, approved.

Commissioner of Income-tax v. Jubilee Mills Ltd., [1963] 48 I.T.R. 9, referred to.

CIVIL APPELLATE JURISDICTION : Civil Appeal Nos. 2177 & 2178 of 1969.

Appeals by certificate from the judgment and order dated February 24, 1969 of the Calcutta High Court in Income-tax Reference Nos. 210 and 211 of 1964.

B. Sen, Leila Seth, U. K. Khaitan and B. P. Maheshwari for the appellant.

B. B. Ahuja, S. P. Nayar and R. N. Sachthey, for the respondent.

A. The Judgment of the Courts was delivered by

KHANNA, J. These two appeals on certificate are directed against the judgment of Calcutta High Court whereby it answered the following question in the affirmative and in favour of the revenue :

B. "Whether in the facts and circumstances of the case, the provisions of section 23A were rightly invoked."

C. The matter relates to assessment years 1952-53 and 1953-54. It would, however, be convenient to set out the facts relating to the year 1952-53 because the decision in regard to the assessment for that year would also govern the assessment for the following year. The assessee-appellant is a limited company. Proceedings under section 23A of the Indian Income Tax Act, 1922 (hereinafter referred to as the Act) were started against the appellant company as it had not declared any dividend during the year. The Income Tax Officer found that the income of the assessee company had been determined in regular assessment to be Rs. 22,65,227 and despite that it had not declared any dividend. The Income Tax Officer observed that there were only two big shareholders of the assessee company, namely, Jiyajeerao Cotton Mills Ltd., Birlanagar (Gwalior) (hereinafter referred to as JC Mills) and Punjab Produce and Investment Co. Ltd. (hereinafter referred to as PPI Co.). JC Mills, in the opinion of the Income Tax Officer, could not be regarded as a member of the public as it was being represented on the Board of Directors through its General Manager D. P. Mandalia. PPI Co. was found to be a company to which the provisions of section 23A of the Act were applicable. These two companies between themselves held 3,21,594 shares out of the total shareholding of 3,70,000 shares. As the shares held by the public, in the opinion of the Income Tax Officer, came to less than 25 per cent of the total shareholding, the assessee company was held to fall within the purview of section 23A of the Act. The Income Tax Officer also referred to article 33 of the Memorandum and Articles of Association of that assessee company, according to which the directors could without assigning any reason decline to register a transfer to a transferee of whom they did not approve. This fact was held to be a definite restriction on the transfer of shares. It was further observed that the shares of the assessee company were not quoted in stock exchange. After deducting Rs. 8,40,524 on account of tax payable on Rs. 22,65,227 the balance of Rs. 14,23,703 was deemed by the Income Tax Officer to have been distributed amongst the shareholders.

H. On appeal before the Appellate Assistant Commissioner, it was urged on behalf of the assessee company that JC Mills and PPI Co. were companies in which the public was substantially interested and, as such, the shareholding of these public companies

should be considered to be shares held by the members of the public. The Appellate Assistant Commissioner did not go into the question as to whether or not the above mentioned two companies were such in which the public was substantially interested. He observed that groups of the two companies were controlling the affairs of the assessee company and as such, the shares held by them could not be considered to be shares held by the members of the public. The appeal filed by the assessee was accordingly dismissed.

The matter was then taken up by the assessee in appeal before the Income Tax Appellate Tribunal. It was urged before the Tribunal that JC Mills was a public limited company to which the provisions of section 23A of the Act were not applicable. It was also pointed out that the PPI Co. was a company to which the provisions of section 23A did not apply. A copy of the order of Appellate Assistant Commissioner made in appeal filed by PPI Co. was produced before the Tribunal. The Appellate Assistant Commissioner had by that order set aside the order of Income Tax Officer and had held that section 23A of the Act did not apply to PPI Co. The Tribunal observed that both JC Mills and PPI Co. were public companies in which the public were substantially interested and, therefore, it was not correct to say that the shares held by the two companies were controlled by a group of persons as distinguished from members of the public. The Tribunal further observed that the usual clause in the Memorandum and Articles of Association empowering the directors to decline to register a transfer of shares without assigning any reason did not mean any restriction on the transferability of shares by one holder to another. The Tribunal also found that there was nothing to show that the shares were not in fact freely transferable. The Tribunal consequently upheld the assessee's contention that it was a public limited company in which the public was substantially interested and its share were freely transferable. The provisions of section 23A of the Act were held to have been wrongly invoked. The order of the Income Tax Officer in this respect was consequently set aside. The question reproduced above was thereafter referred to the High Court. The High Court by a short order answered the question in the affirmative and in this connection relied upon an earlier decision of the Calcutta High Court in *Commissioner of Income-tax, West Bengal v. Tona Jute Co. Ltd.*⁽¹⁾.

In appeal before us, Mr. Sen on behalf of the appellant has contended that the decision of Calcutta High Court in *Commissioner of Income-tax, West Bengal v. Tona Jute Co. Ltd.* (supra) has been impliedly overruled by a decision of this Court in the

(1) [1963] 48 I.T.R. 902.

A case of *Shree Krishna Agency Ltd. v. Commissioner of Income-tax (Central), Calcutta*⁽¹⁾. This contention in our opinion is well founded. In the case of *Tona Jute Co.* (supra) the Calcutta High Court had expressed the view that a public limited company whose directors had absolute discretion to refuse to register transfer of a share to any person whom it would, in their opinion, be undesirable in the interest of the company to admit to membership and were not obliged to give any reason for refusal to register, was not a company the shares of which were freely transable to other members of the public within the meaning of section 23A of the Act. A view contrary to that of Calcutta High Court was taken by the Madras High Court in *East India Corporation Ltd. v. Commissioner of Income-tax*⁽²⁾ and the Bombay High Court in *Raghuvanshi Mills Ltd. v. Commissioner of Income-tax*⁽³⁾. This Court in the case of *Shree Krishna Agency Ltd.* (supra) approved the view taken by the Madras and Bombay High Courts. This Court in that case dealt with article 37 of the Articles of Association of the assessee company which was a public company and which provided that the directors might at any time in their absolute and uncontrollable discretion and without assigning any reason decline to register any proposed transfer of shares. It was held that in the absence of evidence to show that the directors had been exercising their power under article 37 freely and had virtually eliminated the element of free transferability of the shares in the company, the mere existence of an article like article 37 could not be said to affect the free transferability of the shares as contemplated by the explanation to section 23A of the Act.

There is in the present case also no evidence to show that the directors had eliminated the element of transferability of shares. As such, we find that the decision of the High Court in answering the question against the assessee cannot be sustained.

F On an earlier date of hearing Mr. Ahuja, on behalf of the revenue, prayed for adjournment to ascertain whether there was any cogent material on the record to show that there was any group acting in concert which was in control of the assessee company. The adjournment was granted. When the hearing of the case was resumed thereafter, Mr. Ahuja on behalf of the department frankly stated that he had not been able to find any cogent material to show that there was any group acting in concert which was in control of the assessee company. He, however, prayed that the case be remanded to the authorities concerned for going into this question. As the matter relates to the assessment year 1952-53 and as Mr. Ahuja in spite of adjournment has not been able to find any cogent material to warrant the plea that a group acting

(1) [1971] 82 I.T.R. 372.

(2) [1966] 61 I.T.R. 16.

(3) [1969] 74 I.T.R. 823.

in concert was in control of the assessee company, we are of the opinion that we should not accede to the prayer of Mr. Ahuja in this respect. The fact that two public limited companies were holding between themselves more than 75 per cent of the shares of the assessee company was not sufficient to attract section 23A of the Act, A

The case of *Commissioner of Income-tax v. Jubilee Mills Ltd.*⁽¹⁾ referred to by Mr. Ahuja cannot be of much assistance to him. In the said case the Managing Agents of a company were partners of a firm who held between themselves more than 75 per cent of the voting power. It was held that as more than 75 per cent of voting power was held by a group, the company was not a company in which the public were substantially interested within the meaning of section 23A. In the present case as appears from the resume of facts, more than 75 per cent of shares of the assessee company are held not by a group of partners, but by two public companies in which public are substantially interested. This is also no material to show that any group acting in concert is in control of the assessee company. As such, the case of Jubilee Mills cannot be said to have any material bearing. B C D

We accordingly accept the appeals, set aside the judgment of the High Court and discharge the answer given by it to the question referred to it. We answer the said question in the negative and in favour of the assessee. The assessee-appellant shall also be entitled to the costs of this Court and in the High Court. One set of hearing fee. E

V.P.S.

Appeals allowed.

(1) [1963] 48 I.T.R. 9.