

In Re: Dinshaw Maneckjee Petit Bart

In Re: Dinshaw Maneckjee Petit Bart

SooperKanoon Citation : sooperkanoon.com/346366

Court : Mumbai

Decided On : Nov-29-1926

Reported in : AIR1927Bom371; (1927)29BOMLR447

Judge : Amberson Marten, Kt., C.J. and ;Kemp, J.

Appeal No. : Civil Reference No. 20 of 1926

Appellant : In Re: Dinshaw Maneckjee Petit Bart

Judgement :

Amberson Marten, Kt., C.J.

1. For the financial year 1925-26, the assessee Sir Dinshaw Petit has been assessed for super-tax on an aggregate income of Rs. 11,35,302 arising in the previous year. Of this sum he objects to Rs. 3,90,804 made up of two sums of Rs. 2,76,800 and Rs. 1,14,004, the former of which arises from Government and other fixed interest bearing funds, and the latter from dividends in companies. Nothing appears to turn on this distinction, and I shall accordingly ignore it. Admittedly the assessee is the legal owner of moat of these funds in the sense that they stand in his name and the interest and dividends are paid to him direct. Admittedly as regards the rest, the apparent legal owners are his nominees, and he receives the interest and dividends. Admittedly he has retained all the above interest and dividends, and applied the same to his own use. But he contends that he is only a trustee for certain family companies which he has formed: that the interest and

dividends are theirs and not his: that he has credited them in account, and that though he has had the benefit of them in specie this is because the family companies have lent him these moneys at interest which he has credited to them in account, although he has not actually paid the interest in cash. He says that the family companies are under no obligation to declare a dividend, and are entitled to lend out their income in this way, even though it results over a series of years in the fixed preference dividends being unpaid and a large sum representing back income being accumulated in the hands of the assessee.

2. The Advocate General on the other hand contends that the alleged disposition by the assessee in favour of each family company is a sham, as is also the declaration of trust, that the transactions are all paper transactions and not real. That if the family company carries on any business, it does so solely as the agent of the assessee, and that in any event the alleged loans are not genuine loans. He consequently claims that the sums in dispute represent taxable income of the assessee under Sections 2 (15), 3, 6, 12, 55, 56 and 58 of the Indian Income-tax Act, 1922.

3. In consequence of this dispute, the Commissioner of Income-tax has stated a case for our opinion on the four questions of law submitted in para 15. Question (4) deals with the genuineness of the alleged loans, but in para. 33 the Commissioner explains the basis on which he has submitted this question, although in one sense it may be said to be a question of fact.

4. Turning to the facts, it appears that in the year 1921 the assessee formed four private companies which I will call family companies for convenience of reference, although in fact no other member of his family took any direct benefit thereunder. The names of these four companies were Petit Limited; The Bombay Investment Company Limited; The Miscellaneous Investment Limited ; and the Safe Securities Limited ; Each of these companies took over a particular block of investments belonging to the assessee. But as the modus operandi was substantially the same in each case, it will suffice to follow out the fortunes of Petit Limited.

5. Taking then Petit Limited as an example, this family company was incorporated about April 12, 1921 (see Exhibit D), with a nominal capital of rupees ten millions

divided ultimately into 9,99,900 ordinary shares of Rs. 10 each and one hundred preference shares of Rs. 10 each carrying a fixed cumulative preferential dividend of six per cent. Its issued and subscribed capital consists of 3,48,604 fully paid ordinary shares all held by the assessee, and three fully paid preference shares held by three persons who are alleged in para. 24 of the case to be his subordinates and to be entirely under his control, the first being the Secretary of the Petit Charities, the second being the Secretary of the four family companies, and the third being a clerk in the same companies. Its primary object as set out in Clause 3 (1) of its Memorandum of Association was to enter into the agreement of April 12, 1921, Exhibit B, under which the assessee sold to the family company 498 shares in Maneckji Petit Manufacturing Company Limited for Rs. 34,86,000 at the rate of Rs. 7,000 per share in consideration of the family company allotting him 3,48,600 fully paid shares of Rs. 10 each in its capital.

6. By a contemporaneous indenture of April 12, 1921, Exhibit C, the assessee executed a declaration of trust which recited an agreement that the 498 shares should not be transferred until the family company should call upon the assessee to do so, and that in the meanwhile the assessee and his nominees would hold the 498 shares as agents and trustees of this family company. The testatum then contained a formal declaration of trust of these shares by the assessee for the family company and an agreement by him to cause his nominees to make a similar admission. The schedule showed that of these 498 shares, 254 stood in his name and 200 in the name of his wife, and the rest in the names of some thirteen other nominees. It is common ground that hitherto no formal transfers have been called for by the family company. Consequently the formation of the family company has made no difference to the names in which these 498 shares are held on the register of the Maneckji Petit Manufacturing Company Limited.

7. As regards the interest and dividends on the 498 shares, admittedly they have been ultimately paid to the assessee throughout. Taking for example the entries of September 10, 1924, in the books of the family company itself the cash book Exhibit F shows a receipt of Rs. 24,900 for a half year's dividend which appears at p. 18 of the ledger Exhibit H, and is then debited at p. 19 to the current account of the assessee. This current account also contains a debit of Rs. 40,549 in respect

of interest due by the assessee on the alleged moneys of the family company as shown in the journal entry Exhibit G. It also shows a total debit balance against the assessee of Rs. 7,14,103 which is included in the balance sheet Exhibit I. Accordingly, on the assessee's own showing, the family company has been accumulating all its past income by handing it over to the assessee at interest with the result that by December 31, 1924, the total had reached Rs. 7,14,103. It has not even paid its preference dividend of in all Rs. 30 per annum on the three preference shares held by the three subordinates of the assessee. It, however, purported in its balance sheet Exhibit I to set aside rupees six laces to a Depreciation and Reserve Fund Account. This, says counsel for the assessee, was a wise provision for a rainy day. And indeed *Burland v. Earle* [1902] A.C. 83 may be cited as an authority for the proposition that in general a company is entitled to place profits to a depreciation or to a reserve fund, and that dissentient shareholders in the absence of a declaration of dividend or bonus or a winding-up cannot challenge the decision of the majority (see p. 94), provided the powers are exercised bona fide (see p. 97).

8. So much for the accounts. I need not go into them in any greater detail. It suffices to say that the dividends on the 498 shares remained in fact with the assessee from first to last. All the rest represented book entries, which might represent the truth or might not.

9. As for the family company itself, its activities were of the most modest description, despite the thirty-eight objects mentioned in its memorandum. Indeed, apart from the primary object of entering into the above agreement with the assessee, it has done little or nothing except to vary it in an important particular by the declaration of trust, Exhibit C. There has been no additional buying or selling as contemplated by object 2. The 498 shares remain-as they were-in the safe hands of the assessee or his nominees. So does the income also. The company has been too timid to indulge in any active business. It has been content to be a holding company, and as counsel for the assessee truly points out, there is no general law against that.

10. Turning to the Articles of Association, they give the assessee complete control as governing director (see Art. 93); and indeed there is no other director, for Article 96 which prescribes a minimum of two directors only applies if there is no governing director (see Art. 95). Accordingly, under Articles 120 and 93 he may exercise all the powers of the company not required to be done at a general meeting. This would, I think, enable him to lend money under object 4. But dividends have to be declared by a general meeting (see Articles 72, 127 and 128). The fiduciary position of the assessee is to be no bar to the company being bound by the agreement Exhibit B (see Article 4); though, having regard to Article 95, it is perhaps not clear that Article 103 enabling directors to contract with the company applies to the assessee. The declaration of trust Exhibit C is not referred to. The audited accounts when approved by a general meeting are to be conclusive except as regards errors discovered within three months. (See Article 150).

11. It is clear, then, that the company has to act as the assessee wills, provided the terms of the Indian Companies Act are complied with. But here I wish to emphasize the warning which Younger L. J. (as he then was) gave in *Inland Revenue Commissioners v. Samson* [1921] 2 K.B. 492:-

Now, speaking for myself, I do in the light of these considerations, deprecate in connection with what are called one-man companies the too indiscriminate use of such words as simulacrum, sham, or cloak-the terms found in this case- or indeed any other term of polite invective, Not only do these companies exist under the sanction, even with the encouragement of the Legislature, but I have no reason whatever to doubt that the great majority of them are as bona fide and genuine as in a business sense they are convenient and suitable media for the provision and application of capital to industry. No doubt there are amongst such companies, as amongst any other kind of association, black sheep; but in my judgment such terms of reproach as I have alluded to should be strictly reserved for those of them and of their directors who are shown to deserve condemnation, and I am quite satisfied that the indiscriminate use of such terms has, not infrequently, led to results which were unfortunate and unjust, and in my judgment this is no case for their use.

12. And then at pp. 516-7 the learned Judge says:-

In my judgment so long as such a company as this was is recognized by the Legislature there can be no reason why the contracts and the engagements made in its name or entered into on its behalf, and themselves ex facie regular, should not everywhere until the contrary is alleged and proved be regarded as the company's and not those of somebody else, any more than there is any reason why the contracts and engagements and transactions, say even of such a company as the London and North Western Railway Company, should not be regarded as regular until the contrary is shown, To my mind it is strange that it should be necessary to insist upon this aspect of the case at this time of day. But until it is fully realized the loyal adherence to the principles of Salomon's Case, to say nothing of obedience to the declared policy of the Legislature- which is required of all Courts-will not be forthcoming.

13. This brings me then to the law on the points in dispute, and I may preface my observations by saying that I have almost been brought up as it were on Salomon's case, for when I was a pupil in the Chambers of Mr. R.J. Parker, he with the independence and clarity of thought which afterwards characterised his judgments on the Bench, advised that the decisions first of Mr. Justice Vaughan Williams and afterwards of the Court of Appeal were erroneous in law-a view which was afterwards upheld by the House of Lords. I am, therefore, not likely to depart now from the principles of Salomon's case even though I am in a different land. It is indeed one of the foundations of modern Company law, and until one can grasp the true significance of the legal entity thus created by Statute, much must remain dim to the understanding of those grappling with the subject.

14. Let us start then clearly with this that there was here a company duly incorporated under the Indian Companies Act, and that this company was a separate entity from the assessee Sir Dinshaw Petit, just as much as, say, his secretary or any other third party might be. But because there was this separate entity which I will call X, it does not necessarily follow that every alleged transaction between the assessee and X was valid or that it represented a real transaction. We in this country are extremely familiar with the benamidar. Benami

transactions abound, for they are employed extensively to hide the truth from inquisitive eyes. For instance, in a mofussil appeal last term we had a case of the truth being hidden for over thirty-seven years, the modus operandi being for many years a sham mortgage, and later on for even greater security a sham sale to a third party (see *Patel Dahyabhai Maneklal v. Bai Matu* (1026) First Appeals Nos. 316 of 1924 and 251 of 1925, decided by Marten C.J. and Patkar J. on August 21, 1926 (Unrep.)). In that particular case the motive was to defeat creditors, should a speculative business prove unfortunate. No doubt in many cases the rules of evidence prevent the parties to the instrument from giving oral evidence to show that the document is not what it purports to be. But these rules do not prevent the Crown from enquiring into the truth in the present case, for, in my judgment, Section 92 of the Indian Evidence Act does not apply here. (See *Maung Kyin v. Ma Shwe La* (1917) L.R. 44 IndAp 236.

15. It is contended by counsel for the assessee that we are bound to accept the agreement Exhibit B, and declaration of trust Exhibit C of April 12, 1921, as effecting in law what they purport to effect. In my judgment, that contention is erroneous. Whether the separate entity is a company or an individual matters little or nothing in this respect. With the company just as with the individual you may start with the presumption that a duly executed transfer is a genuine document. But you may yet eventually find on proper evidence that in fact it was an instance of the sham transfer which we are all familiar with in the ease of individuals, even though the transaction ends with the formal registration of the document before the Registrar, and the handing over of the purchase consideration in cash in his presence- cash which is conveniently provided by a third party for a few hours or minutes, and which will be restored to him after the conclusion of the ceremony before the Registrar. It is on a par with funds provided for what is known as 'window dressing purposes' in the City of London at the close of a particular financial period. And as regards the point I am now on, I see no vital difference between cash in the shape of coin or notes on the one hand and shares on the other hand. Coin or notes are more easy to manipulate, for coin cannot easily be traced and notes probably will not be in this country. Shares can be traced, but they have this advantage over coin that only a printing press is requisite. And should the transaction be upset, it only means that the shares will never in* law

have left their slumber as uncalled or nominal capital, or at any rate must be restored to their slumber. There is consequently no risk of any one depriving any of the parties of what does really matter, viz., the coin or notes of the Realm.

16. But though I hold that it is permissible in law for the Crown to enquire into the genuineness of the transactions between the assessee and the family company, it would be quite wrong to start with the presumption that those transactions are sham ones. On the contrary one should start with the presumption that they are genuine, and throw the onus on the Crown to prove the contrary. (See Lord Justice Younger's judgment in Sansom's case [1921] 2 K.B. 492 already cited). We must, therefore, look closely into the facts of the present case, and then see whether there is evidence sufficient in law to enable the Commissioner to hold-as he did hold- that the Crown had discharged that onus. Or as it might be said in a jury case whether there was in law evidence to go to the jury, and whether on that evidence a jury of reasonable men could find that in fact the transactions were sham ones.

17. Now the main facts here are not disputed. I have already set them out, and need not repeat them. And one striking element is that the company has never yet obtained sole legal possession and control of the property which it purported to buy. Nor can one point to clear and definite evidence that the Company is carrying on a genuine business as a separate entity. The registered agreement of sale of April 12, 1921, Exhibit B, which was mentioned in the Memorandum and Articles of Association, was an ordinary contract for the sale and purchase of a block of shares. In the natural course of events that contract should have been completed by a formal transfer and delivery of the share certificates, and the subsequent entry of the company's name as share-holder. (See *Maneckji Pestonji Bharucha v. Wadilal Sarabhai & Co.* Why then should there be the unregistered document, Exhibit C, of the same date by which the company was not to get the ordinary rights of a purchaser, and to that extent was not to carry into effect the agreement, Exhibit B, mentioned in Clause 3 (1) of the Memorandum What advantage could the company get by being content with a declaration of trust by the vendor alone And if it represented a genuine bargain, why should it be thus concealed from those inspecting the Memorandum or searching the Register On the other hand,

one can clearly see the disadvantages to the company by the course the alleged transaction took. Substantially the company could not begin the business contemplated by Clauses 3(2) and (3) of the Memorandum until they de facto acquired the shares which constituted their only asset. A law suit might be necessary to force the alleged trustee or his nominees to execute the necessary transfers or to deliver up the share certificates. And there were other risks in thus leaving all their property in the hands of a sole trustee or his nominees, for he and they could have given a good title to any third parties who presumably would be quite ignorant of the alleged but concealed trust. On the evidence before us, the company has not even got any admission of this trust by the fourteen nominees of the assessee set out in the schedules to Exhibits B and O. For all we know, they may not even be aware of it, despite the agreement by the assessee in Exhibit C that he will cause these nominees to admit the trust. It is true that the agreements set out the denoting numbers of the shares. And so the shares may be said to be earmarked as being the company's property. In this respect the copy agreements in the case stated have made a serious omission. They do not contain the denoting numbers, but I have called for the originals, and find that in fact these numbers were inserted. I have also called for and inspected the file of the company kept by the Registrar of joint stock companies, and I find that although neither of the original documents bears any registration mark, the inference I should otherwise draw from the minute of April 12, 1921, Exhibit D, is correct, viz., that the agreement Exhibit B was registered but that the declaration of trust, Exhibit C, was not registered. Should, however, the Maneckji Petit Manufacturing Company Limited have Articles of Association in a common form giving it a prior lien for advances to any individual shareholders, then it may be that the family company might be postponed should the assessee or his nominees be indebted to the Maneckji Company.

18. No substantial argument was advanced to us to explain why the device of this concealed declaration of trust was resorted to. One can hardly accept the excuse given to the Income-tax authorities that it was to save trouble that formal transfers were not executed. If so, why go to the trouble of two documents Exhibits B and C instead of one. The real reason may be to preserve the assessee's voting powers in the Maneckji Company. But that is a matter again for his benefit, and not

necessarily for the company's advantage. It would be quite consistent with the transaction being a sham one.

19. Turning next to the alleged loans of the dividends year by year to the assessee, it appears clear that it is the assessee who receives these dividends in the first instance from the Maneckji Company. There is no suggestion that the Maneckji Company has been instructed to pay those dividends to the family company. Accordingly, the rest is merely a matter of book entries, viz., to credit the cash to the company and then to transfer it to the debit of the assessee's account. The actual cash which after all is the important thing is kept by the assessee throughout. And one startling circumstance is that beyond the accounts we have nothing in writing whatever to establish the alleged agreement for loan by the family company. Of the importance of this alleged agreement there can be no doubt. By it the family company practically bound itself hand and foot to do no business, for its cash immediately on receipt was to be handed back to its vendor and promoter at a fixed rate of interest. And yet there is not even a minute on the subject. And we are asked to infer the agreement from the accounts and the yearly balance-sheets. If, however, this was a genuine agreement, why should it also not see the light of day, or at any rate find a place in the company's minute book And none the less so because the governing director with his wide powers was purporting to lend the company's money to himself.

20. The result is that we have here a case which is the exact opposite of *Salomon v. Salomon & Co.*, [1897] A.C. 22 in the essential facts which I am now considering. There was a genuine and prosperous business in Salomon's case, viz., that of a boot and shoe manufacturer (see p. 47). That business was transferred to the limited company, and there was no question but that thenceforth the limited company carried on that business. That the company subsequently fell on evil days was no fault of Mr. Salomon. He tried to save it (p. 49), and Lord Macnaghten expressly negatived any fraud or dishonesty on his part (p. 52). Nor was there any concealment. The creditors were, therefore, forced to argue that in effect no separate entity was created by the Statute, and that a person holding the bulk of the shares might be held liable as if he was the sole proprietor or a partner. That contention the House of Lords demolished.

21. So, too, in *Inland Revenue Commissioners v. Sansom* [1921] 2 K.B. 492 (which I have already cited) there was a genuine timber business carried on by the limited company, which made large profits during the war. These profits were not distributed in dividend, but were alleged to have been lent to Mr. Sansom the governing director who held all the shares but one. The question was whether these loans were genuine. Mr. Sansom himself gave evidence and satisfied the Commissioners he was telling the truth. The appellate Court confirmed their decision, and pointed out that Mr. Sansom's case was corroborated by the fact that one of the alleged loans had undoubtedly been paid by him to the family company. Here we have nothing of that sort. The assessee has not ventured to give any evidence, and the finding of the Commissioner is against the truth of his story. Nor have any of the alleged loans been repaid. If then the Court of Appeal in Sansom's case had the present facts before them, I think their judgments shew that a different conclusion would have been arrived at. Thus Lord Sterndale M.R. says (p. 501) :-

I think it only needs the statement of those facts to show that anybody would approach the matter with a very considerable amount of suspicion, and I think the *prima facie* tendency of anybody's mind would be to say : 'This transaction of loans or advances without security and without interest is a mere fiction. It is all nonsense, and the real fact is that Mr. Sansom was receiving under the guise of loans or advances the profits which were made by the company which he controlled and in which he held practically the whole of the shares.' That, I think, would have been one's impression off-hand. And that no doubt was part of but only a part of the case which was made before the Commissioners. Now the Commissioners have found that these were genuine loans, that they were loans by the company to Mr. Sansom, and that they were not mere pretences to hide the fact that he was receiving the profits of the company. They saw him ; he was examined before them, and I suppose they had before them all Mr. Sansom's and the company's books and all the materials that could be provided. They are business men who I have no doubt have heard of one-man companies and are perfectly familiar with the questions which arise upon them, and they were certainly as well fitted as we are to come to a conclusion of fact in the matter. They did come to that conclusion. I shall allude to the particular terms of their findings

later on, but they did come to that finding. It seems to me that for reasons which I shall give this really puts an end to this case, which, in my opinion, depends entirely upon questions of fact.

22. And Scrutton L. J. says (p. 506):-

That assessment came before the Commissioners, who had to decide on this point whether these were genuine loans or whether they were merely a disguise for profits of the company received by the shareholder. Now personally I feel that I should have approached the consideration of that question with the strongest presumption that they were really profits and not loans; the whole thing looks extremely suspicious. But the Commissioners saw Mr. Sansom, they heard him cross-examined, they heard other witnesses, they heard all that could be said on either side, and they heard that in the earlier years of the company a similar loan appeared in the books which had been repaid by Mr. Sansom to the company, and after hearing all the evidence they found that these were genuine loans. Now, whatever I might have thought, not having seen the witnesses, I do not see how I can possibly interfere with a finding of the Commissioners, who are judges of fact, and who have seen Mr. Sansom, that these were genuine loans.

23. And Younger L. J. says (p. 517):-

I wish, however, to express, if I may be allowed to do so, my fullest concurrence with what has fallen from Scrutton L. J. and also from the Master of the Rolls on the question in relation to these loans, as it must have presented itself to the Crown before the case came before the Special Commissioners at all. The transactions between Mr. Sansom and the company in relation to these loans are indeed on the face of them very singular.

24. Lord Justice Younger further goes on to point out the singular feature that Mr. Sansom was thus exercising his powers as governing director to lend the company's moneys to himself without interest and without security. The case for our decision presents similar features, except that the alleged loan is said to carry interest.

25. I next turn to *Jacobs v. The Commissioners of Inland Revenue* (1925) 10 T.C. 1 which was a case decided in the Court of Session, Scotland, on June 4, 1925, by the Lord President (Lord Clyde) and Lords Cullen and Sands. There, again, there were genuine businesses, viz., shops carried on by the several companies in which Mr. Jacobs held substantially all the shares. Here also the profits were alleged to have been lent to Mr. Jacobs. But in this case the Special Commissioners held that the loans were not genuine loans, and the Court of Session upheld his decision. Lord Clyde in the course of his judgment stated as follows (p. 15):-

My Lords, in this case the question, and the only question, put to us is whether the Special Commissioners were entitled to find that the sums withdrawn were part of the Appellant's income and as such liable to Super-tax. We are not the Judges of Appeal on questions of fact but on questions of law only, and therefore the only question before us is whether the Appellant can make out that upon the facts, either admitted or proved, which are itemised [from page 2 to the end of page 8]...the Commissioners could legally-that is to say, could reasonably, without being unreasonable-arrive at the finding in fact which is submitted for our consideration...I confess I can find no ground at all which would justify me in saying that the Commissioners were not entitled to form the conclusion in fact at which they did arrive...I think it is probably true that it would have been better if the last part of that finding had been expressed in the same form as the earlier portions of the finding are expressed, namely, a finding that the loans were not genuine loans but were in point of fact payments drawn from the profits of these companies by the Appellant and formed part of his income. But, after all, that is nothing but a question of form ; it is not one of substance ; I have no doubt at all that on the facts, admitted or proved, there was ample ground upon which the Commissioners could reasonably arrive at the result which they reached, and that is enough for the decision of the only question put to us. I think the question ought to be answered in the affirmative.

26. That case seems to me very close to the present one, except that here we have not got a company carrying on an open business like a shop. The circumstances, therefore, are more unfavourable to the assessee.

27. If, however, the genuineness of the alleged transfer or declaration of trust is once admitted, there is another class of case which is clearly set out in the judgment of Scrutton L. J. in Sansom's case, at p. 507, and which raises 'the question whether it can be said that the business which is being carried on by a company is really the business of an individual and consequently the profits made by that company are really his profits, and he is assessable in respect of them'. In the American brewery cases, for instance, it has been held that the business carried on in America ostensibly by an American company was really the business of the English company which held all the shares. (See, for instance, *Apthorpe v. Peter Schoenhofen Brewing Co. Ltd* (1899) 4 T.C. 41. On the other hand in *The Kodak, Limited v. Clark* [1908] 2 K.B. 89 and in *Gramophone and Typewriter, Limited v. Stanley* [1903] 1 K.B. 505 it was held that the profits of the foreign company were not the profits of the English company, and that the English company was not carrying on the business of the foreign company.

28. I do not propose to go into further details as regards those decisions, nor need I base my decision on them, but I may refer to Lord Justice Scrutton's criticisms when he says (p. 509):-

In the Gramophone Case Lord Cozens-Hardy M.R. said that there might be circumstances and arrangements which would make a business carried on by a company the business of an individual by virtue of the arrangements and by virtue of his control. Speaking for myself-I am not at all sure that my brothers take the same view as I do-once you get an independent shareholder in the secondary company it is impossible to say that the business of the secondary company is the business of the man who owns most or nearly all of the shares in that company. The profits do not belong to the man who holds most of the shares ; they belong to the shareholders through the company, and the moment you get Mr. Hime with one share, quarrelsome and independent, in my view it is impossible to find that the business is the business of the man who owns all the rest of the shares ; it is the business of the man who owns all the rest of the shares and Mr. Hime.

29. In the present case, however, the part played by the quarrelsome and independent Mr. Hime in Sansom's case falls to the lot of three subordinates of the

assesses. But they can hardly be said to be in the same independent position as Mr. Hime, and there is no suggestion that they are quarrelsome. They have not even been paid their preference dividends, and no protest on their part is on record. Further, we have here a feature which is not present in the other cases, viz., that the alleged transfer or declaration of trust is itself challenged.

30. It was argued for the assessee that in England legislation became necessary to defeat the device of accumulating profits and refusing to declare a dividend (see Section 21, Finance Act, 1922); and that we are really being asked to do what legislation alone can enable us to do. But that argument does not touch a sham transfer nor a sham loan. And in any event I think it is erroneous in the present case. This is not the first time when plausible paper schemes under the Companies Acts have not stood the test of examination in a Court of law. And even if it should be held that the payment of the moneys to the assessee was illegal without a declaration of dividend, it may yet be that the assessee would be liable for tax as was the case of the bookmaker in *Partridge v. Mallandaine* (1886) 18 Q.B.D. 276 or as regards the illegal abwabs in *Birendra Kishor Manikya v. Secretary of State for India* I.L.R. (1920) Cal. 766 It is however, unnecessary for me to decide this latter point.

31. On the other hand, the fact that the family company has paid tax on the interest credited to it by the assessee in respect of the alleged loans does not necessarily involve the conclusion that the loans were genuine, nor estop the Crown from now showing that these loans were illusory. Paying tax on the alleged interest arising from the loan was much cheaper for the assessee than paying super-tax on the dividends themselves.

32. Nor do I feel pressed by *Attorney-General v. Richmond (Duke)* (No. 1). [1908] 2 K.B. 729 There the transactions were genuine ones, though their legal effect might be to defeat the Crown's future claims to duty. If the initial transaction had been challenged as here, the case might have been different. Thus Lord Atkinson states [1909] A.C. 466

I further think that the case must be determined solely with regard to the legal rights and interest which the respective parties had acquired in October, 1897, the

date of execution of the impeached securities. What they did afterwards, how they chose to dispose of those legal interests or be exercise those legal rights, is, in my view, irrelevant. It might have been legitimate to inquire into these matters subsequent, if the transactions which were concluded on that day had been impeached as unreal, colourable, or sham transactions ; but they have been admitted to be real and genuine in their character, and, if so, all the subsequent dealing with the estate and the interest created in it lie outside the field of inquiry, even though by their operation they practically restore the status quo ante.

33. After giving then my best consideration to the able arguments presented by counsel, I have arrived at the clear conclusion that there was here in law evidence on which the Commissioner might reasonably find as a fact (1) that there was no genuine transfer or declaration of trust in favour of the family company, and (2) that the alleged loans were not genuine loans. I would, according, hold on questions Nos. 1 and 4 that in law the Commissioner was entitled on the facts to decide question No. 1 in the affirmative and question No. 4 that the loans in question were not genuine loans but were merely withdrawals of income disguised as loans.

34. Questions Nos. 2 and 3 should each be answered in the negative.

35. Speaking for myself, I would prefer to confine my judgment to the path indicated for the High Court in Section 60 (5) of the Indian Income-tax Act, 1922, viz., the decision of the questions of law raised in the case stated by the Commissioner. (Cf. *Rex v. Bloomsbury Income Tax Commissioners* [1915] 3 K.B. 768 *Jacobs v. The Commissioners of Inland Revenue* (1925) 10 T.C. 1

36. But as the Commissioner to some extent invites our opinion on the facts, and as it may be argued that one or other of the questions is a mixed question of law and fact, I may be permitted to add that on the law and the facts, I would answer question No. 1 in the affirmative, and question No. 4 by holding that the loans in question were not genuine loans but were merely withdrawals of income disguised as loans. Accordingly, in my judgment, the sums in dispute represented taxable income of the assessee under the Indian Income-tax Act, 1922.

37. A copy of our judgments should be sent to the Commissioner as provided by Section 66 (5). I would order the assessee to pay the costs of this reference.

Kemp, J.

38. This is a reference under Section 66 (2) of the Indian Income-tax Act, XI of 1922, and involves the consideration of the legal entity known as a 'one-man company.' The assessee is a well known and wealthy citizen of Bombay and the assessment relates to the financial year 1925-26.

39. The questions submitted for our opinion are set out in paragraph 15 of the reference. It is unnecessary to detail them at length in my judgment.

40. The assessment relates to super-tax. The Income-tax Officer calculated the petitioner's total income liable to super-tax at Rs. 11,35,102 and assessed the super-tax on it at Rs. 8,20,975-12-0. This sum of Rs. 11,35,102 includes (1) Rs. 2,76,800 interest on securities, i. e., Government paper, Port Trust Bonds &c, in the assessee's name, and (2) Rs. 1,14,004 dividends on shares in limited companies in the assessee's name. The Income-tax Officer regarded these as part of the assessee's income. The assessee contends that they are the income of four private limited companies formed by him and that the companies are liable to the super-tax on them.

41. Now super-tax levied on limited liability companies is at the flat rate of one anna in the rupee after allowing for the statutory deduction of Rs. 50,000. On individuals super-tax is levied at scale rates of one anna rising to six annas, starting with one anna for the first Rs. 50,000 after allowing for the statutory deduction of Rs. 50,000 and rising by half an anna for each subsequent 50,000 up to a maximum of six annas. Thus, if the amounts in question be the assessee's private income the super-tax will be Rs. 1,46,551, and if they be the income of the companies it will be Rs. 11,925 only.

42. The four limited liability companies are of the same nature and were formed in the same way. The four companies are (1) Petit Limited, (2) The Bombay Investment Company Limited, (8) Miscellaneous Investment Company Limited,

and (4) Safe Securities Company Limited. It will be sufficient for the purposes of the reference to take as a typical case the first company, Petit Limited, I may here say that out of the total subscribed capital of over thirty to forty lacs of each company, only shares of the face value of Rs. 30 were not in the assessee's name. These last were in the names of his employees, who are under his control. All the shares and securities stand in the name of the assessee or his nominees but the assessee says that they belong to the companies.

43. Taking the case of Petit Limited, it was a company which was registered on April 12, 1921, with a capital of one hundred lacs divided into ten lacs of shares of Rs. 10 each. There were one hundred preference shares and the remaining 9,99,900 shares were ordinary shares. The issued capital is 3,48,604 ordinary shares and three preference shares. The three preference and four ordinary shares were paid for in cash, i. e., Rs. 70. The assessee took up all the other ordinary shares. The three preference shares were allotted one to the secretary, Petit Charities, one to the secretary of the four companies, and one to the clerk of the four companies. The assessee held 498 shares-some in his own name and some in the names of his nominees-of the Maneckji Petit Company of the value of Rs. 7,000 each. By an agreement dated April 12, 1921, (Exhibit B), the assessee purported to sell these shares to the company in return for the allotment of the company's shares, i. e., for 3,48,604 ordinary shares. Then by a declaration of trust (Exhibit C) of the same date in favour of Petit Limited in which it is recited that it was agreed that the shares and securities were not to be transferred until the Company called upon the vendor to do so but that in the meantime the vendor and his nominees should hold the respective shares standing in their respective names as agents and trustees for the company, the vendor stood possessed of the shares upon trust for the company and agreed to cause all his nominees to admit they held the shares in their names as trustees for the company. No transfers have been called for by the company. What happened subsequently was this. As soon as the dividend and interest on the shares and securities were received by the assessee a book entry was made in the books of Petit Limited crediting that company with the amount and on the same day a debit entry was made debiting the assessee with the same amount. In other words the interest never found its way into Petit Limited but when received by the assessee was treated as an

advance made to him by the company. At the date of the last balance sheet a sum of over rupees seven lacs is shown as due by the assessee in the books of Petit Limited for these alleged advances and accrued interest. It may be mentioned that no interest was paid in cash but the interest was added to the amount of the loans in the books of Petit Limited. The only cash, therefore, which Petit Limited received, was the Rs. 70 for the three preference and four ordinary shares,

44. The Memorandum of Association of the company contains thirty-eight objects for which it was formed and a perusal of the Articles of Association, especially Articles 4, 6, 34 and 93, shows that the governing director of the company, i. e., the assessee himself, had a paramount say in the affairs of the company. It was possible for two other ordinary directors to be nominated by him but, so far as the evidence before us goes, no such directors have been nominated and in fact the governing director, i. e., the assessee, has had the entire control and management of the company. No remuneration was paid to him as governing director (see Article 93, Clause 4, in this connection). The meeting of the so-called board to record the company's registration was attended only by the assessee himself as governing director and the solicitor to the company.

45. The Income-tax Commissioner contends that this is not a genuine one-man company and that the dividends on the shares and securities are really the income of the assessee.

46. Now this was a one-man company. It was properly formed and registered as a company under the Indian Companies Act and it had a separate legal entity. There was nothing *prima facie* illegal about it. *Younger L. J.*, in *Inland Revenue Commissioners v. Sansom* [1921] 2 K.B. 492-

Now, speaking for myself, I do in the light of these considerations, deprecate in connection with what are called one-man companies the too indiscriminate use of such words as *simulacrum*, *sham*, or *cloak*-the terms found in this case-or indeed any other term of polite invective. Not only do these companies exist under the sanction, even with the encouragement of the Legislature, but I have no reason whatever to doubt that the great majority of them are as *bona fide* and genuine as in a business sense they are convenient and suitable media for the provision and

application of capital to industry.

Starting, therefore, with this assumption of a perfectly valid legal entity created by the assessee, we have to consider whether this assumption has been rebutted. It is admitted that the company has paid no dividend and here it may be appropriate to refer to the distinction with reference to super-tax as regards limited liability companies in England and in India. In England prior to the Act of 1922 limited liability companies were not liable to super-tax. It was found, however, that in some cases they avoided payment of income-tax by omitting to declare a dividend on their profits. Consequently, the Act of 1922 was passed in England which enabled the revenue authorities to declare what should have been a proper dividend for the company to have declared for the purposes of assessment of income-tax. Here in India, as I have already pointed out, limited liability companies are liable to super-tax but at a rate which is very much less than the rate of super-tax on the income of individuals. It is, therefore, obvious that it was to the assessee's interest that the dividends and shares should be considered as belonging to the company rather than to himself. The well-known case of *Salomon v. Salomon & Co.* [1897] A.C. 22 shows that where there is a genuine transfer by an individual of his business to a limited liability company consisting even of himself and his family so long as the business carried on by the company is its business and is really not the business carried on by the individual himself and the requirements of the Indian Companies Act have been complied with, the individual is not liable to indemnify the company against the claims of its creditors. Nevertheless, as stated by the Lord Justices in the case of *Inland Revenue Commissioner v. Sansom* above referred to, one naturally approaches a company formed in the circumstances in which a company in that case was formed with suspicion. In that case, however, the learned Lord Justices held that the company was a genuine company and they gave effect to the finding of the Commissioners that the moneys received by Sansom were really loans from the company and not mere pretences to hide the fact that the assessee was himself receiving the profits of the company. I take it that from the observations of the Lord Justices in that case one may properly infer that had the moneys received by Sansom not been found by the Commissioners to be loans, they would have held that the assessee Sansom was assessable to income-tax in respect of them. Otherwise with what

object did the Lord Justices go into the question of the genuineness of the company formed by Sansom? In that case also Scrutton L. J. discusses the question which he says has been fought backwards and forwards in various shapes ever since he has known any thing about income-tax law between the skilled counsel for the Crown and skilled counsel who protect the interests of the taxpayer and the question he refers to is, 'Whether it can be said that the business which is being carried on by a company is really the business of an individual and consequently the profits made by that company are really his profits and he is assessable in respect of them' (p. 507). Similarly, in what are known as the American brewery cases-the *Apthorpe v. Peter Schoenhofen Brewing Co., Ltd.* (1899) 4 T.C. 41 *St. Louis Breweries, v. Apthorpe* (1898) 4 T.C. 111 and *United States Brewing Company, Limited v. Apthorpe* (1898) 4 T.C. 17 the Commissioners found as a fact in each case that the head and seat of the Government of the American company were in England, and that the business carried on in America was the business of the English Company. I think it is clear, therefore, that, apart from the effect to be given to a finding of the Commissioners, the Court is entitled to go into the question as to whether the so-called one-man company is really a business carried on by the assessee himself for the purposes of avoiding payment of tax, In *Gramophone and Typewriter, Limited v. Stanley*, [1908] 2 K.B. 89 the Court held that the mere fact that one company holds all the shares in another does not necessarily make the second company the business of the first. And the same would be the case where an individual held all the shares in a company. At p. 104 of the report Buckley L. J. lays down what it is essential for the Attorney-General to prove to succeed in such a case. In the Scotch case of *Jacobs v. The Commissioners of Inland Revenue*, (1925) 10 T.C. 1 the Lord President pointed out the effect to be given to a finding of fact by the Commissioners that the sums withdrawn by the appellant were part of his income.

47. In the present case the Commissioner has found that the sums alleged to have been advanced by the company as loans were part of the assessee's income; but quite apart from the question of what weight should be given to such a finding, I am of opinion, on an application of the principles laid down in the cases I have cited, that *Petit Limited* was not a genuine company at all but merely the assessee himself disguised under the legal entity of a limited liability company.

48. I have already referred to the control which the assessee in this case exercised under the Articles of Association and as the holder of all the issued ordinary shares in this company. The three preference shares were held by his nominees and employees. This is not a case where an independent person was the owner of even one share when it might be contended on the opinion of Lord Justice Scrutton in Sansom's case that the business would not necessarily be the business of the man who owns all the rest of the shares. A perusal of the current account in the company's books shows that the dividends and interest alleged to have been received by the company were credited in the limited share account of the company and the same day debited to the assessee by way of loan. As I have pointed out none of the dividends or interest ever reached the company. Only credit and debit entries were made. Nor was any interest paid on the amount of the loan standing to the assessee's debit in the books of the company but the interest was credited every year to the company in the account. Here I may properly deal with the contention that because the Income-tax Authorities have hitherto treated the dividends and interest as part of the income of the company, they are now estopped from contending otherwise. In my opinion, they are not barred from claiming on an investigation of the true facts of the case that the profits of the company are really the income of the assessee liable to super-tax.

49. There are other facts which suggest that the company in this case was formed by the assessee purely and simply as a means of avoiding super-tax and that the company was nothing more than the assessee himself. It did no business but was created purely and simply as a legal entity to ostensibly receive the dividends and interest and hand them over to the assessee as pretended loans. In the balance-sheet as at December 31, 1914, the amount set down for depreciation and the balance on profit and loss account make up the balance standing to the debit of the assessee in his current account on January 1, 1924. The expenses in the company's Profit and Loss account Rs. 15,383-11-0 are debited to the assessee's current account with the company. The whole of the dividends and interest on the shares and securities ostensibly supposed to belong to the company have been from year to year received by the assessee and merely credit and debit entries made in the company's books to support the case of a series of loans made every year to the assessee. The assessee's current account with the company shows

the large amount of Rs. 7,14,103-8-11 due by him for these alleged loans and interest on them. Nothing has been repaid on this account and in this connection it may be observed that in Sansom's case the Courts found that some of the earlier loans had been repaid.

50. The only cash with the company is Rs. 70 made up of the amount paid for the three preference and four ordinary shares.

51. The shares and securities stand in the assessee's name. The agreement dated April 12, 1921, between the assessee and Petit Limited provided for the purchase of the shares by the allotment of 3,48,600 fully paid up shares. The indenture of trust recites that it has been agreed that the shares shall not be transferred until the company calls upon the vendor so to do and then proceeds to declare that the vendor shall stand possessed of shares in the company. As a matter of fact the company has not called on the vendor to transfer the shares. I agree that one may look at this case from a consideration of the question whether there has been any real trust or not, but I think the shares being in the assessee's name and the dividends having been received by him it lies on him to show in the first instance that as a matter of fact he really holds them for a company and not on his own behalf. In other words, he must show he is trustee for the company. I think he has not only failed to show this but the evidence establishes that as a matter of fact he really held the shares on his own behalf and for his own benefit whilst professing to hold them as trustee for a genuine and bona fide company.

52. The company has declared no dividends. The memorandum of association of the company contains thirty-eight objects; yet the company's activities have been restricted to the supposed receipt of the dividends and interest on the shares and securities supposed to belong to it; and for six years the company has only received the dividends and interest by paper entries and passed it on to the assessee by way of a supposed loan. So far as the alleged loan itself is concerned, no resolution of the company has been produced to show that it was sanctioned or the rate of interest which was to be charged. It was made without security and no vouchers have been taken for the advances.

53. Counsel for the assessee has referred to the case of Attorney-General v. Richmond (Duke) (No. 1) [1908] 2 K.B. 729 on appeal [1909] A.C. 466 but that case is distinguishable from the present one. There the object was to bar the entail and the Duke did create an effective arrangement although incidentally it had the effect of escaping death duty. Later, the fee simple was charged but the transaction was not a fictitious one in the opinion of the majority of the House.

54. I am, therefore, of opinion that in this case the assessee was receiving under the guise of loans or advances the profits which were made by the company which he controlled and in which he held all the shares except three which were held by his subordinates. The company was created by him merely, so that he could make entries in the company's books suggesting that it received the interest and dividends and paid them as loans whilst in reality the receipt of dividends and interest, if it could be called the business of the company, was its only business and was in fact the business of the assessee himself.

55. This really disposes of the argument put forward by counsel for the assessee that if these moneys received by his client were not loans they were moneys wrongfully received by him which he is bound to refund to the company and on which, therefore, he is not assessable to super-tax, I am not prepared, in any case, to accede to this argument where, if the company be regarded as carrying on its own business separate to that of the assessee, it has made no attempt and apparently does not intend to recover such sums from the assessee.

56. Nor can the moneys received by the assessee be regarded as dividends paid by the company on its shares ; for the company paid no dividends and the moneys are not entered in its books as such.

57. I would answer the questions

1. In the affirmative.

2. No.

3. No.

4. They were not genuine loans but merely withdrawals of income disguised as loans.

58. The assessee to pay costs of reference taxed as on Original Side and by Taxing Officer.

59. Per Curiam. The judgment of the Court will be: Answer Question No. 1 in the affirmative : Questions Nos. 2 and 3 in the negative: and Question No. 4 by holding that the loans in question were not genuine loans but were merely withdrawals of income disguised as loans. The assessee is to pay the costs of this Reference to be taxed as on the Original Side, such costs to be taxed by Taxing-Officer.

SooperKanoon - India's Premier Online Legal Search - sooperkanoon.com