

Cit Vs. Light Publication Ltd.

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Court : Gujarat

Decided On : Nov-24-2000

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Appeal No. : IT Ref No. 369 of 1984, 135 of 1985 & 39 of 1986 24 November 2000 A.Y. 1978-79 to 1980-81

Appellant : Cit

Respondent : Light Publication Ltd.

Advocate for Pet/Ap. : Akil Qureshi i/b Manish R. Bhatt, *for the Revenue* K.H. Kaji, *for the Assessee*

Judgement :

A.R Dave, J.

As questions referred to this court in all these references are common, at the request of the learned advocates, the references are heard together and are disposed of by this common judgment.

2. At the instance of the revenue , the following two questions of law have been referred to this court by the Tribunal, Ahmedabad Bench 'C', under the provisions of section 256(1) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act').

'1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that the status of the assessee-company should be treated as public limited company?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that notwithstanding the provisions of section 2(18) of the Income Tax Act, 1961. The status of the assessee-company should be taken as a public limited company?'

3. The short question which has arisen in all these references is whether the assessee-company should be treated as a public limited company or in other words a 'company in which the public are substantially interested' for the assessment years 1978-79 to 1980-81. For the said assessment years different references have been made and the said references, as stated hereinabove, are being disposed of together by this common judgment.

4. The facts and circumstances in which the above questions have arisen are as under :

5. The assessee-company was initially a private limited company within the meaning of the provisions of the Companies Act, 1956, and was being assessed as such. During the relevant assessment years, initially, the assessing officer had assessed the assessee as a public limited company because more than 25 per cent shares of the company were held by one or more body corporate. In the circumstances, the assessing officer, looking to the provisions of section 43A of the Companies Act, considered the assessee as a public limited company and assessed the company as a 'company in which the public are substantially interested' as per the provisions of section 2(18) of the Act.

6. The Commissioner did not think the assessment to be proper and, therefore, he exercised his powers under the provisions of section 263 of the Act and after hearing the assessee, came to the conclusion that the company was not a 'company in which the public are substantially interested' and he assessed the company as a private limited company. For doing so, he had considered the fact that, by virtue of the clauses incorporated in the articles of association of the

assessee-company, there was a restriction on the transfer of shares and as the shares of the assessee-company were not freely transferable, the Commissioner did not consider the assessee as a public limited company.

7. Being aggrieved by the order passed by the Commissioner, the assessee-company filed appeals for the relevant assessment years before the Tribunal. The Tribunal allowed the appeals by holding that the assessee-company was a public limited company. While allowing the appeals, the Tribunal had relied upon the judgment delivered by the Hon'ble Supreme Court in the case of Shri Krishna Agency Ltd. v. CIT : [1971]82ITR372(SC) . Moreover, the Tribunal came to the conclusion that, by virtue of the provisions of section 43A of the Companies Act, the status of the assessee-company had been changed and the company had become a public limited company. Thus, the orders passed by the Commissioner under the provisions of section 263 of the Act had been set aside and the orders of the assessing officer were restored.

8. We have heard learned advocate Shri Akil Qureshi for the revenue and learned advocate Shri K.H. Kaji for the assessee. We have also considered the relevant judgments cited by the learned advocates and have also gone through the relevant record including the articles of association of the assessee-company.

9. Learned advocate Shri Qureshi appearing for the revenue has submitted that though the assessee-company had become a public limited company by virtue of the provisions of section 43A of the Companies Act, the assessee-company had become a public limited company only by virtue of a deeming fiction under the provisions of the Companies Act, but the assessee-company had retained the basic characteristic of a private limited company because, as per its articles of association, there was a restriction on the transfer of shares of the assessee-company. According to Shri Qureshi, the Commissioner was right when he observed that the assessee-company had put up a restriction on the transfer of its shares by virtue of the clauses incorporated in its articles of association and, therefore, the assessee-company had retained the basic characteristic of a private limited company. He has referred to the relevant sections of the Act and the Companies Act and has submitted that the assessee-company was not a

'company in which the public are substantially interested'. He has relied upon the following judgments to substantiate his submissions..

(i) Shree Krishna Agency Ltd. v. CIT (supra);

(ii) CIT v. Lucas T.V.S. Ltd. : [1995]214ITR700(Mad) ; and

(iii) CIT v. East West Import and Export (P) Ltd. : [1989]176ITR155(SC) .

10. On the other hand, learned advocate Shri Kaji has tried to justify the order passed by the Tribunal by submitting that the assessee-company had become a public limited company as more than 25 per cent of its shares were held by bodies corporate. He has further submitted that the restrictions on transfer of shares of the assessee-company referred to by the Commissioner in his order were in reality not restrictions imposed upon transfer of the shares of the assessee-company. He has submitted that in articles of association of practically all the companies such restrictions are always incorporated. So as to substantiate his submission, he too has relied upon the judgment delivered in the case of Shri Krishna Agency (supra) by the Supreme Court.

11. Before dealing with the questions which have been referred to us, let us look at the provisions which are relevant for the purpose of answering the questions.

12. Section 2(18) of the Act, at the relevant time, defined 'company in which the public are substantially interested', as under :

(18) 'Company in which the public are substantially interested'--A company is said to be a company in which the public are substantially interested .

(a) if it is a company owned by the Government or the Reserve Bank of India (RBI) or in which not less than forty per cent of the shares are held (whether singly or taken together) by the Government or the RBI or a corporation owned by that bank; or

(aa) if it is a company which is registered under section 25 of the Companies Act, 1956 (1 of 1956); or

(ab) if it is a company having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by order of the Board to be a company in which the public are substantially interested:

Provided that such company shall be deemed to be a company in which the public are substantially interested only for such assessment year or assessment years (whether commencing before the 1-4-1971, or on or after that date) as may be specified in the declaration; or

(b) if it is a company which is not a private company as defined in the Companies Act, 1956 (1 of 1956), and the conditions specified either in item (A) or in item (B) are fulfilled, namely :

(A) shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) were, as on the last day of the relevant previous year, listed in a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956 (42 of 1956), and any rules made thereunder.,

(B) (i) shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than fifty per cent of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant previous year beneficially held by

(a) the Government, or

(b) a corporation established by a Central, State or Provincial Act, or

(c) any company to which this clause applies or any subsidiary company of such company where such subsidiary company fulfils the conditions laid down in clause (b) of section 108 (hereafter in this clause referred to as the subsidiary company), or

(d) the public (not being a director, or a company to which this clause does not

apply);

(ii) the said shares were, during the relevant previous year, freely transferable by the holder to the other members of the public; and

(iii) the affairs of the company, or the shares carrying more than fifty per cent of its total voting power were at no time, during the relevant previous year, controlled or held by five or less persons.

Explanation I : In computing the number of five or less persons aforesaid,-

(i) the Government or any corporation established by a Central, State or Provincial Act or a company to which this clause applies or the subsidiary company of such company shall not be taken into account, and

(ii) persons who are relatives of one another, and persons who are nominees of any other person together with that other person, shall be treated as a single person.

Explanation 2: In its application to an Indian company whose business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power, item (B) shall have effect as if for the words 'not less than fifty per cent' and 'more than fifty per cent' the words 'not less than forty per cent' and more than sixty per cent' had, respectively been substituted. '

Another relevant section is section 43A of the Companies Act. The relevant portion of the said section reads as under :

43A. (1) Save as otherwise provided in this section, where not less than twenty five per cent of the paid-up share capital or a private company having a share capital is held by one or more bodies corporate, the private company shall,-

(a) on and from the date on which the aforesaid percentage is first held by such body or bodies corporate, or

(b) where the aforesaid percentage has been first so held before the commencement of the Companies (Amendment Act, 1960), on and from the expiry of the period of three months from the date of such commencement unless within that period the aforesaid percentage is reduced below twenty-five per cent of the paid-up share capital of the private company become by virtue of this section a public company :

Provided that even after the private company has so become a public company its articles of association may include provisions relating to the matters specified in clause (iii) or sub-section (1) of section 3 and the number of its members may be or may at any time be reduced, below seven:

13. Some of the facts which are not in dispute are as under :

More than twenty-five per cent of the share capital of the assessee-company had been held by bodies corporate at the relevant time. It is also pertinent to note that for all the assessment years in question or for part thereof, there was a restriction, according to the articles of association of the company, with regard to transfer of shares of the assessee-company.

14. The relevant provisions of the articles of association, which pertain to transfer of shares are as under :

4. The company being a private company, the following provisions shall have effect, viz.,

(i) The right of transfer of shares of the company shall be restricted as hereinafter provided.

(ii) The number of members of the company (exclusive of persons who are in the employment of the company) is not to exceed fifty, but where two or more persons hold one or more shares in the company jointly, they shall for the purposes of this article, be treated as a single member.

(iii) Any invitation to the public to subscribe for any shares of the company is hereby prohibited.

34. No transfer of shares shall be registered unless a proper instrument of transfer duly stamped together with corresponding certificate of title of share or allotment letter thereof has been delivered to the company. The instrument of transfer of any share will be executed both by the transferor and transferee or by their duly constituted attorney/s and the transferor shall be deemed to remain the holder of such shares until the name of the transferee is entered in the register in respect thereof.

36. Subject to article 40 the Board may in their absolute discretion refuse to register any transfer of shares to a transferee of whom they do not approve not being member of the company. But the Board may, before the transfer is effected give permission in advance for a contemplated transfer and as such permission shall be binding upon the company.

37. A share may be transferred by a member or other person entitled to transferor to any member selected by the transferor, but save as provided by article 41 hereof no share shall be transferred to any person who is not a member unless such person is approved of by the Board as one whom it is desirable in the interest of the company to admit to membership.

40. (1) On the death of a member, the survivor or survivors where the member was a joint holder, and his legal representatives where he was a sole holder, shall be the only person recognised by the company as having any title to his interest in the shares.

(2) Nothing in the above clause shall release the estate of a deceased joint holder from any liability in respect of any share which has been jointly held by him with other persons.

41. Any person becoming entitled to a share in consequence of the death or insolvency of a member shall, upon such evidence being produced as may from time to time be required by the Board, have the right either to be registered as a member in respect of the share or instead of being registered himself, to make such transfer of the shares as the deceased or insolvent person could have made, but the Board shall in either case have the same right to decline or suspend

registration as they would have had in the case of a transfer of the shares by the deceased or insolvent person before his death or insolvency.

42. A person becoming entitled to a share by reason of death or insolvency of the holder shall be entitled to the same dividends and other advantages to which he would be entitled if he were the registered holder of the share, except that he shall not be entitled in respect of it to exercise any rights conferred by membership in relation to meetings of the company..

Provided that the Board may at any time give notice requiring any such person to elect either to be registered himself as a member or to transfer the share and the notice is not complied with within ninety days the Board may thereafter withhold payment of all dividends, bonuses or other moneys payable in respect of the shares until the requirements of the notice have been complied with.

43. Except where transfer is made pursuant to articles 36, 37 and 39 herein, no shares in the company shall be transferred unless and until the rights of preemption hereinafter conferred shall have been exhausted.

44. Every member or other person referred to in article 41 of these articles of association who intends to transfer shares (hereinafter referred to as 'The Proposing Transferor') in which he is directly or indirectly concerned or interested shall give notice in writing to the Board of his intention specifying details of shares to be sold and the proposed sale price. Such notice shall constitute the Board his agent for the sale of the said shares, in one or more lots, at the discretion of the Board to members of the company at a price to be agreed upon by the proposing transferor and the Board, or in case of difference, at the price to be determined by the auditors of the company.

45. Upon the price fixed or determined as aforesaid the Board shall forthwith give notice to all the members of the company of the number and price of the shares to be sold and invite each of them to state in writing within twenty-one days from the date of the said notice whether he is willing to purchase any, and if so, what maximum number of the said shares.

46. At the expiration of the said period of twenty-one days, the Board shall allocate the said shares to or amongst the member or members who shall have expressed his or their willingness to purchase as aforesaid and (if more than one) so far as may be pro rata according to the number of shares already held by them respectively provided that no member shall be compelled or obliged to take more than the said maximum number of shares so notified by him as aforesaid. Upon such allocation being made, the proposing transferor shall be bound on payment of the said price to transfer the shares to the purchaser or purchasers and if he makes default in so doing, the Board may receive and give a good discharge for the purchase money on behalf of the proposing transferor and enter the name of the purchaser in the register of members as holder by transfer of the said share or shares purchased by him.

47. In the event of the whole or part of the said shares not being sold under article 44 within ninety days from the date of notice as aforesaid, the proposing transferor may subject to article 48 at any time thereafter within three months after the expiration of the said period of ninety days, transfer the shares not so sold to any person and at any price.'

15. On the basis of the aforesaid facts and looking to the relevant provisions of law, we have to consider the question whether the assessee-company was a private limited company or it was a 'company in which the public are substantially interested' during the relevant period. In the instant case, we are concerned with clause (b) of section 2(18) of the Act. As per the said sub-section, if a company, which is not a private company as defined in the Companies Act, 1956, and the conditions specified either in clause (A) or in clause (B) are fulfilled, the company can be said to be a 'company in which the public are substantially interested'. Clause (A) is not applicable and, therefore, we have to look at the provisions of clause (B). All conditions specified in clause (B) are required to be fulfilled so as to enable the assessee-company to be considered as a 'company in which the public are substantially interested' or a public limited company as described by the Tribunal in its order. Condition (ii) specified in clause (B) is with regard to free transferability of the shares. The said sub-clause provides that during the relevant previous year, shares of the company should be freely transferable by the holder

to the other members of the public. Thus, we have to examine whether it was open to the shareholders of the assessee-company to transfer the shares to any person of the public at the relevant time. If there was a restriction on transfer, it could be said that the shares of the company were not freely transferable during the relevant previous year.

16. Now, let us look at the provisions pertaining to transfer of shares in the articles of association of the assessee-company. According to clause 36 of the articles of association, the Board of Directors may in their absolute discretion refuse to register any transfer of shares in favour of a person who is not a member of the company. Thus, the Board of Directors of the assessee-company had a right to refuse any transfer in favour of a person who was not a shareholder. So far as clause 37 of the articles of association is concerned, it was open to a member to transfer the shares to any member selected by the transferor but the members had no right to transfer shares to a person who was not a member of the company and who was not approved by the Board of Directors. Thus, as per the provisions of the articles of association of the company, a shareholder had no right to transfer his shares to a person other than a shareholder of the company without getting a clearance from the Board of Directors. Clause 44 of the articles of association deals with a case where a member who wants to transfer his shares. He has to give a notice in writing to the Board of Directors of his intention of selling the shares. He has also to state the price at which he proposes to sell the shares. In such an event, the Board of Directors gets a right to sell the shares of the shareholder intending to dispose of his shares in favour of the existing shareholders. According to clause 45, the Board of Directors has to give notice to all the members of the company that at a particular price the concerned shareholder wanted to sell his shares and in that event it would be open to the existing shareholders to purchase shares of the company offered for sale by one of the members. In addition to the above condition, there are conditions also relating to fixation of price at which the shares can be sold if the price expected by the proposed transferor and the price fixed by the Board of Directors is not same. The said conditions incorporated in the clauses referred to hereinabove clearly denote that a shareholder cannot directly transfer his shares in favour of a member of the public. If only the existing shareholders are not inclined to purchase

the shares of the proposed transferor, then only, as per the provisions of clause 47 of the articles of association, shares of the company can be transferred in favour of a member of the public. Thus, it is very clear that there is a restriction on transfer of shares as per the provisions of the articles of association of the assessee-company.

17. In case of a public limited company, its shares are freely transferable by its members to other members of the public. This is an essential element which is required to constitute a company in which the public are substantially interested. The clauses incorporated in the articles of association of the assessee-company clearly distinguish its case from the case decided by the Hon'ble Supreme Court in Shri Krishna Agency (supra). The company with which the court was concerned, did not incorporate the restrictions which have been referred to hereinabove. Normally, in the articles of association of all companies, a provision is incorporated whereby the Board of Directors has a right to keep an unwanted element away from becoming a shareholder of the company. Normally it is presumed that the Board of Directors would act in the interest of the company and would not permit an unwanted element to become a shareholder of the company. Refusing to transfer the shares, which is in favour of an unwanted element, is understandable but in normal circumstances, the Board of Directors would invariably permit a shareholder to transfer shares to another member of the public in a public limited company. That is not the case here.

18. In the instant case, there is a clear provision in the articles of association that before effecting any transfer of shares by any of the shareholders, the shareholder desirous of transferring his shares has to give a notice to the Board of Directors. He has to announce the price at which he has to sell the shares. All the members of the company are asked whether they would like to purchase the shares. If everybody refuses to purchase the shares, then only the shareholder intending to transfer the shares is permitted to sell shares to the public. Even if the person to whom the shares are to be sold is not an unwanted element, by virtue of the provisions incorporated in the articles of association of the company, the person intending to purchase the shares would not be in a position to purchase the shares. This is nothing but a restriction on transferability of the shares.

19. Thus, it is very clear, in the instant case, that all the conditions incorporated in section 2(18)(b)(B) of the Act have not been fulfilled.

20. The word 'public' has not been defined under the Act. While dealing with the term 'company in which the public are substantially interested', in *Raghuvanshi Mills Ltd. v. CIT* : [1961]41ITR613(SC) , the Supreme Court has observed that, the word 'public' is used in contra-distinction to one or more persons who act in unison and among whom the voting power constitutes a block.' Looking to the said meaning of the term 'public', it is very clear that when a shareholder of the company transfers his shares to another shareholder of the company, he is not transferring his shares to a member of the public. Thus, when a shareholder is constrained to transfer his shares to another shareholder, he is not freely transferring his shares to a member of the public. If a shareholder is permitted to transfer his shares to a person of his choice, who is not a shareholder of the company, without any unreasonable restriction, then only it can be said that the shares are freely transferable to a member of the public.

21. It is also pertinent to note the provisions of clauses 40, 41 and 42 of the articles of association of the company. In the event of death of a member, the heirs of the member inherit the shares of a shareholder. The legal heirs would get a limited right to get dividend and they would not get any other right as shareholders. The said clauses also not only put a restriction with regard to free transferability of the shares but it also restricts even transmission of the shares. According to the said clauses, it would not be open to a shareholder to bequeath his shares to someone of his choice.

22. The aforesaid conditions incorporated in the articles of association clearly restrict free transferability of the shares to other members of the public. In view of the said provisions, one cannot say that the assessee-company was a company in which public are substantially interested.

23. Submission of learned advocate Shri Kaji that as per the provisions of section 43A of the Companies Act, the assessee-company had become a public limited company is not of much substance for the reason that section 43A of the Companies Act deals with a situation when certain private companies are to be

treated as public limited companies. For definition of the word 'company' one has to look at section 3(1) of the Companies Act. Clause (iii) of section 3(1) defines 'private company' as under :

(iii) 'private company' means a company which, by its articles,-

(a) restricts the right to transfer its shares, if any;

(b) limits the number of its members to fifty not including-

(i) persons who are in the employment of the company; and

(ii) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased; and

(c) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this definition, be treated as a single member.

Upon perusal of clause (a) of the said definition it is clear that a 'private company' is a company which by its articles restricts the right to transfer its shares. Even if a private limited company becomes a public limited company by virtue of the provisions of section 43A of the Companies Act, the basic characteristic of the private company as stated in the definition referred to hereinabove remains. In the instant case, the assessee-company had restricted the right of the shareholders to transfer the shares. Thus, the assessee-company had retained a very important characteristic of a private limited company and, therefore, it can be said that the assessee-company was not a public limited company. Even if one looks at the proviso to section 43A of the Act, it is very clear that even after a private company becomes a public limited company, its articles of association may include provisions relating to the matters specified in clause (iii) of sub-section (1) of section 3 of the Companies Act. Thus, even after becoming a public limited

company by virtue of the provisions of section 43A of the Companies Act, the public company retains the characteristics of a private limited company and, therefore, such a company may be a 'company in which the public are substantially interested.' In the instant case, we are concerned with the proceedings under the Act and we have to look at the provisions of section 2(18) of the Act. So a private company becoming a public company by virtue of the provisions of section 43A of the Companies Act may still not become a 'company in which the public are substantially interested' due to restriction imposed on its shareholders upon transferability of its shares to the other members of the public.

24. In the course of arguments it has been submitted by the learned advocate appearing for the assessee that the assessee-company had resolved to make necessary changes in the articles of association to remove the restriction on transferability of its shares. It is an admitted fact that the shares of the assessee-company were not freely transferable during the entire period in question. The Supreme Court has held in case of CIT v. East West Import Export (P) Ltd. (supra) that the shares should be freely transferable for the entire previous year. In view of the fact that the shares of the assessee-company were not freely transferable during the entire previous years in question, it cannot be said that the shares were freely transferable during the relevant years in question.

25. In the course of arguments, it has been submitted on behalf of the advocate appearing for the assessee that neither the Tribunal nor the Commissioner has referred to all the provisions incorporated in the articles of association of the assessee-company relating to transferability of its shares. In the circumstances, it has been submitted by him that this court should not look at the clauses which pertain to restriction on transfer of shares by the members of the company. We do not agree with the said submission made by learned advocate Shri Kaji because here the question is whether there was any restriction on transferability of the shares of the assessee-company. It is not in dispute that the articles of association of the assessee-company was considered by the Commissioner and by the Tribunal. Both the authorities had made reference to the provisions of the articles of association of the company. In that event, it cannot be said that this court cannot look at the other relevant provisions of the articles of association of the

company especially when this court has to decide whether shares of the company were freely transferable during the period in question. In view of the fact that the articles of association of the company is on the record of this court and as it was duly referred to by the Commissioner and the Tribunal, we are of the view that this court can consider all the relevant clauses pertaining to imposition of restriction on transferability of shares of the assessee-company while deciding the question whether the assessee-company was a private limited company, or, the assessee-company was a 'company in which the public are substantially interested.'

26. In view of the facts stated above, we are of the view that the shares of the assessee-company were not freely transferable to the other members of the public and, therefore, it was neither a public limited company nor was it a 'company in which the public are substantially interested.'

27. As both the questions are interconnected, we answer both the questions by our common answer in the negative, that is, in favour of the revenue and against the assessee.

The references stand disposed of accordingly with no order as to costs.