

(2014) 02 GUJ CK 0005
In the Gujarat High Court

Case No : Special Civil Application Nos. 14422 and 14423 of 2008

Dhaval N. Patel

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 26-02-2014

Acts Referred:

Constitution of India, 1950 — Article 226
Income Tax Act, 1961 — Section 179, 221(1), 264

Citation : (2015) 126 CLA 35 : (2014) 184 CompCas 367 : (2015) 2 CompLJ 44

Hon'ble Judges : Sonia Gokani, J; Akil Abdul Hamid Kureshi, J

Bench : Division Bench

Advocate : Tushar P. Hemani, Advocate for the Appellant; Nitin K. Mehta, Advocate for the Respondent

Judgement

Sonia Gokani, J.—Facts are common in both the petitions. Therefore both the petitions are heard together and are being disposed of by this common judgment. For the purpose of this judgment we may notice the facts as arising in Special Civil Application No. 14422 of 2008. Challenge in this petition preferred under article 226 is made to the issuance of order u/s 179 of the income tax" Act, 1961 ("the Act" hereinafter) dated January 11, 2005, as also to order passed u/s 264 of the Act dated March 19, 2008.

2. The factual background necessary for adjudication is as follows:

The petitioner was a promoter/director of a public limited company named Lanzorate Finance (India) Ltd., which was originally incorporated as Ravit Vinimay Ltd., with the Registrar of Companies on August 19, 1992 and obtained the certificate of commencement of business as on September 17, 1992. The company was engaged in the business of secondary market operations and project consultancy and, thereafter, started its activity of equipment leasing. The company came out with its public issue of equity shares on June 18, 1996. It is averred that the prospectus of the company provides details of the company. The petitioner resigned from the company on May 31, 2000, due to change in the

management.

For the assessment year 1996-97, amount of tax demanded from the company was to the tune of Rs. 53,18,694. In view of the petitioner being the director of the said company at the relevant point of time, a show-cause notice was issued u/s 179 on November 17, 2004, proposing to recover such arrears of tax from the petitioner.

Vide its reply dated November 26, 2004, it was contended by the petitioner that such notice is not maintainable as the company was a public limited company and provisions of section 179 would not be applicable. The Assessing Officer however, passed an order on January 11, 2005, holding the petitioner jointly and severally liable for such tax demand and a consequent notice was issued on January 31, 2005, to recover the said amount. The petitioner preferred Special Civil Application No. 11542 of 2006 challenging the validity of such notice. The court vide its order dated July 18, 2006, dismissed the petition on the ground that no evidence was adduced to show that the company was a public limited company and therefore, in the petition under article 226 of the Constitution of India, the court cannot go into those factual details.

The petitioner thereafter, preferred a revision application u/s 264 of the Act challenging the notice impugned. The Commissioner of income tax in its order dated March 19, 2008, dismissed the revision application on the ground that the assessee's special civil application before this court was not entertained and was dismissed, therefore, his application for rectification of order u/s 179 also consequently deserved to be rejected. Resultantly, the present petition challenging both the impugned orders made u/s 179 and order u/s 264 in the revision petition, seeking the following prayers:

(a) direct the respondents to quash and set aside the impugned order u/s 179 dated January 11, 2005, at annexure A to this petition and quash and set aside the impugned order u/s 264 of the Act dated March 19, 2008, at annexure B to this petition.

(b) pending the admission, hearing and final disposal of this petition, stay operation and implementation of the impugned order u/s 179, dated January 11, 2005, at annexure A to this petition.

(c) any other and further relief deemed just and proper be granted in the interest of justice.

(d) to provide for the cost of this petition.

3. We have heard learned counsel Shri Tushar Himani for the petitioner who has fervently contended that the company is a public limited company and, therefore, the very provision is not applicable. He has also pointed out various documents to substantiate his contention that the petitioner was a director of the public limited company which was incorporated from the very beginning as a public limited company and even for the year under consideration, i.e., 1996-97,

the same was a public limited company. He therefore, urged that the act of issuance of notice so also the order of rejection of his revision, both deserve to be quashed.

4. Learned counsel Shri Nithin Mehta appearing for the respondent-Revenue has urged that in the return of income filed for the assessment year 1996-97 on January 5, 1997, the status code in column No. 8 was shown as 13. Code 13 stands for a domestic company which is not a company in which the public are substantially interested and during the period relevant to the assessment year concerned, the assessee company had not raised any public issue. He therefore, urged that the court may not interfere as requested for.

5. On thus hearing both the sides, as also considering the pronouncements on the subject we are of the opinion that the petition deserves to be allowed for the reasons to follow hereinafter.

6. As could be noticed from the materials on record, the petitioner herein was the director of the company which was originally incorporated as Ravit Vinimay with the Registrar of Companies, Gujarat on August 19, 1992. It obtained certificate of commencement of business on September 17, 1992. The company changed its name from Ravit Vinimay to Lanzorate Finance (India) Ltd., and was registered with the Registrar of Companies vide certificate dated December 14, 1995. The petitioner also brought on record a certificate issued by the Registrar of Companies, being the certificate of incorporation as also the certificate of commencement of business and further changed the name to Lanzorate Finance (India) Ltd. It appears that the company thus from the very incorporation was a public limited company and its public issue also were out on June 18, 1996. The petitioner was the promoter/director and continued to be with the company till he resigned from the post on May 31, 2000.

7. The arrears of tax demand raised on the petitioner in his capacity of director by issuance of the impugned notice u/s 179 is for the assessment year 1996-97. The provision of section 179 permits recovery of such tax arrears of a company from the director of the company which is a private company or a private limited company. The provision makes it amply clear that when the company is a public company or a public limited company, such provision would not be applicable. Relevant here would be to refer to the provisions of law and some of the well pronounced judgments on the subject.

8. Section 179 of the income tax Act reads as under:

179. Liability of directors of private company in liquidation.--(1) Notwithstanding anything contained in the Companies Act, 1956 (1 of 1956), where any tax due from a private company in respect of any income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for the payment of

such tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

(2) Where a private company is converted into a public company and the tax assessed in respect of any income of any previous year during which such company was a private company cannot be recovered, then, nothing contained in sub-section (1) shall apply to any person who was a director of such private company in relation to any tax due in respect of any income of such private company assessable for any assessment year commencing before the 1st day of April, 1962.

9. As contained in the said provision, where any tax is due from a private company in respect of any income from the said company or any other company in respect of any income of the company of the previous year during which year such company was a private company, if the Revenue is not in a position to recover, every person who was a director of the private company, during such relevant previous year would be jointly and severally liable for the payment of such tax, unless he proves that non-recovery could not be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company. Sub-section (2) of section 179 of the Act also provides the situation that where the private company converted into public company and the tax in respect of private company could not be recovered, nothing contained in sub-section (1) would be applicable to any person who was a director of such private company in relation to any tax due in respect of any income of such private company assessable for any assessment year commencing before April 1, 1962.

10. This court in Special Civil Application No. 1921 of 2005 (Radhey Mohan Sharma v. Dy. CIT (OSD) [2014] 184 Comp Cas 358 (Guj)) referred to some of the decisions and held thus (page 362):

This court in the case of Pravinbhai M. Kheni Vs. Assistant Commissioner of Income Tax and Others, , had an occasion to deal with the liability of the directors of a public limited company, where the proceedings u/s 179 were initiated against the petitioner-director of such company. Pursuant to search proceedings against the public limited company, the tax liability determined was more than Rs. 155 crores. The Revenue was of the opinion that such company was formed for taking over business of the partnership and the directors had amassed huge wealth in the form of immovable property and disclosed the income had not been on members of the partnership and other had become directors of the company. Such conclusion of the Revenue that the unaccounted income of the company had been misappropriately utilised by the directors and shareholders and company was only a conduit for creation of unaccounted money. The request is made for lifting the corporate veil and recover tax dues of public company. In such a situation, the proceedings were laid down u/s 179 of the Act for lifting the corporate veil. It would be profitable to reproduce the

relevant findings of this court on this aspect as under (page 618):

From the above judicial pronouncements, it can be seen that the concept of lifting or piercing the corporate veil as some times referred to as cracking the corporate shell, is applied by courts sparingly and cautiously. It is, however, recognised that boundaries of such principle have not yet been defined and areas where such principle may have to be applied may expand. Principally, the concept of corporate body being an independent entity enjoying existence independent of its directors, is a well known principle. Its assets are distinct and separate and distinct from those of its members. Its creditors cannot obtain satisfaction from the assets of its members. However, with ever developing world and expanding economic complexities, the courts have refused to limit the scope and parameters or areas where corporate veil may have to be lifted.

Howsoever cautiously, the concept of piercing of corporate veil is applied by the courts in various situations. Two situations where such principle is consistently applied are, one where the statute itself so permits or provides for and the second where due to glaring facts established on record it is found that a complex web has been created only with a view to defraud the revenue interest of the State. If it is found that incorporation of an entity is only to create a smoke screen to defraud the revenue and shield the individuals who behind the corporate veil are the real operators of the company and beneficiaries of the fraud, the courts have not hesitated in ignoring the corporate status and striking at the real beneficiaries of such complex design.

Section 179 of the Act itself is a statutory creation of piercing of corporate veil. Ordinarily, directors of a company even that of a private company would not be answerable for the tax dues of the company. Under sub-section (1) of section 179 of the Act, however, subject to the satisfaction of certain conditions, the directors can be held jointly and severally liable to pay the dues of the company.

In the present case, however, the Revenue desired to apply the principle of lifting the corporate veil in case of a public company and seeking to resort to the provisions contained in section 179 of the Act. In our view, if the factors noted by the Assistant Commissioner are duly established, there is no reason why such double application of lifting the corporate veil one statutorily provided and other due to emergent need of the situation, cannot be applied. As noted above, the factors recounted by the Assistant Commissioner in the impugned order are glaring. The company had defaulted in tax for more than Rs. 155 crores. The same was unearthed during search operations carried out by the Revenue authority. The attachment of the assets of the company could lead to recovery of not more than Rs. 5 crores from such huge outstanding dues. The company was formed for taking over business of the partnership. The members of the partnership firm and other family members of the same family became the directors of the company. Shares of the company were held by them and not by any members of the public. The directors had amassed huge wealth in the form of immovable property. The Assistant Commissioner, therefore, was of the

opinion that the company was only a conduit for creation of unaccounted money and appropriating in directors.

The courts have been, thus, categorical in these judgments that essentially under two conditions the piercing of corporate veil would be applied by the courts one where the statute itself would permit and secondly, where the glaring facts from record emerge. In the case before this court in Pravinbhai M. Kheni Vs. Assistant Commissioner of Income Tax and Others, , the Revenue had put forth sufficient material and when both the conditions of meeting with the emergent need of the situation were held to be duly satisfied, double application of lifting of corporate veil was permitted by the court.

This court in the case of Special Civil Application No. 10686 of 2013 with Special Civil Application No. 10688 of 2013 in the case of Sandeep A. Mehta v. ITO, decided on October 15, 2013, also had an occasion to refer to the decision in the case of Pravinbhai M. Kheni Vs. Assistant Commissioner of Income Tax and Others, . The facts somewhat similar to the present case were presented, wherein the petitioners were the directors of the company, where the notice was issued to the directors for recovery of demand u/s 179 of the Act in their capacity as directors. The company admittedly was a public limited company since the year 1995 and the petitioners were appointed as directors of the company in December, 2005. They were not even shareholders at the time of conversion of the company from private limited company to public limited company. The request was also made by the Revenue to lift the corporate veil. On duly considering the judicial pronouncements on the said aspect and on considering the material on record, the court did not find any need to permit the said request of lifting the corporate veil by holding thus:

23. From the ratio discussed hereinabove, it needs to be examined whether any of the two situations specified in the said decision exist on the record. Firstly, whether the statute itself so permits or provides for lifting of veil and secondly, whether the facts are so glaringly emerging on record whereby it can be found that with a view to defeat the interest of the Revenue, attempt is made by creating complexity of the facts. In the instant case, therefore, in other words, what needs to be examined is whether with a view to defeat the interest of the State some of the real beneficiaries have created complex design and web and have chosen to hide behind the corporate veil. Section 179 of the Act itself is a creation of the statute whereby the corporate veil can be pierced and original directors of the private limited company could be held liable for the outstanding tax dues of the company. The statute, however, has created a situation whereby they can be jointly and severally held liable. In the instant case, the facts are apparently clear whereby conversion of the Amadhi Investment Ltd., from a private limited company to a public limited company was in the year 1995. The petitioners were appointed as directors of Amadhi Investment Ltd., on December 29, 2005. They were not even shareholders of the company from June 5, 1995, till September 30, 2006. Therefore, there would not be any requirement of

establishing that non-recovery of the amount due to the company could be attributed to any gross-negligence, misfeasance or breach of duty on the part of the petitioners in relation to the affairs of the company. Therefore, the very action u/s 179 against the petitioners would not lie. The petitioners since were not directors of the company until December 28, 2005, for the liability of the company pertaining to the assessment year in question, i.e., on 2005-06, they cannot be held liable u/s 179 of the Act.

24. Thus, the statute permits the lifting of the corporate veil section 179 of the Act as one of the modes of the statutes permitting such piercing of the veil provided of course directors of the private company behind the veil are the beneficiaries and who have created such a complex web for their personal interest so as to defraud the Revenue.

25. When the facts are eloquent enough in the instant case, where the petitioners were never concerned with the affairs of the company until December 28, 2005 and the company had already become public limited company and by the time they became directors, they were not even simple shareholders for the entire period till the year 2006, there does not arise any question of applying the ratio of decision of Pravinbhai M. Kheni Vs. Assistant Commissioner of Income Tax and Others, or for that matter upholding the action of the respondents of invoking the provisions of section 179 of the Act.

In the present case, as we can notice, the company M/s. Blue Information Technology is a public limited company. It was incorporated as a public limited company vide certificate of incorporation dated May 25, 1992. It came out with a public issue in June, 1996. The petitioner-director of the said company resigned on September 6, 1997. Admittedly, the dues are of the years 1995-96, 1996-97 and 1997-98. The notice was issued on October 14, 2001, u/s 221(1) of the Act seeking to recover penalty for not having paid the dues of the company for the aforesaid years to the tune of Rs. 297 lakhs. It is not in dispute that the petitioner ceased to act as a director of the company from September, 1997.

With regard to the outstanding dues of the company for the assessment years 1995-96, 1996-97 and 1997-98, the company being a public limited company from May 25, 1992, the certificate of incorporation having come, the very issuance of the notice cannot be sustained unless, of course, as provided in the case of Pravinbhai M. Kheni Vs. Assistant Commissioner of Income Tax and Others, and followed thereafter, in the case of Sandeep A. Mehta v. ITO there are glaring facts which would permit the lifting of the corporate veil. In the present case, as could be noticed, those foundational facts are completely missing. It is not even the case of the Revenue that such claim exist warranting lifting of corporate veil. Except non-fulfilment of the obligation by the company of the tax demands that had arisen as a result of the assessment of all these years, nothing comes on record for the court to permit the piercing of corporate veil. The petitioner being the director of the public limited company, this provision is non-applicable.

Section 179 of the Act chooses to impose a vicarious liability on the director of a private company making his liability co-extensive with the company in respect of arrears of tax of assessment year when he functions as a director. However, the income tax authority in relation to the liability of the company shall need to insist upon its recovery and when the company is unable to discharge such liability and the attempts of the tax authorities to realise such tax dues do not materialise, the director needs to be issued the notice of recovery. These provisions are made in respect of private companies and sub-section (2) of section 179 of the Act makes it abundantly clear that in the case of a public company or public limited company, the very provision is not applicable. As noted above, in the absence of any contrary facts which either require this court to pierce the corporate veil or anything to indicate that the company is other than a public company, the invocation of section 179 of the Act itself shall have to be held bad. It would be, of course, the onus of the petitioner to establish that non-recovery of the amount of tax due to the company could not be attributed to any gross negligence, misfeasance or breach of duty on the part of the petitioner in relation to the affairs of the private company, but, the very action against the petitioner u/s 179 of the Act, when would not lie, the petition, therefore, deserves to succeed.

11. In the wake of such legal position, the only factual contention that requires to be dealt with is the reference of code No. 13 in the return of income filed by the company as it is the code applicable to a domestic company which is a company in which the public is substantially not interested. This solitary circumstance can never be the ground for the Revenue to not recognise other substantive and cogent evidences which are far more pronounced and for which no disputes have been raised at any stage. Mere mentioning of the code as contended by the Revenue could be hardly a ground to allow it to pursue the notice impugned. It is also necessary to note at this stage that the earlier petition preferred before this court was not entertained on the ground that necessary documents for the court to arrive at a decision, whether the company was a public limited company or not, were absent. That ipso facto itself cannot be the ground for the concerned authority not to examine the subject matter on merits in the revision petition. Therefore, both, the order u/s 179 and the consequential order u/s 264 in the revision application, in the light of the above discussion, must fail. The petitions are allowed. Impugned orders u/s 179 dated January 11, 2005 and u/s 264, dated March 19, 2008, are quashed with all consequential proceedings. The petitions are disposed of. Rule is made absolute to the above extent with no order as to costs.