(1977) 01 GUJ CK 0015

In the Gujarat High Court

Case No : Company Petition No''s. 10 and 12 of 1975 in Company Application No''s. 40 and 41 of 1974

**In Re: Wood Polymer Limited
 In Re: Bengal Hotels Pvt. Ltd.**

Date of Decision : 31-01-1977

Acts Referred:

Capital Issues (Control) Act, 1947 — Section 3, 4, 5
Companies Act, 1956 — Section 205(1), 211(3), 221, 244(1), 250
Income Tax Act, 1961 — Section 45, 47

Citation : (1977) 109 ITR 177

Hon'ble Judges : D.A. Desai, J

Bench : Single Bench

Advocate : J.M. Thakore, -General, V.B. Patel, Amicus curiae and Official Liquidator in person, for the Appellant;

Judgement

D.A. Desai, J.—Company Petitions Nos. 10 and 12 of 1975 are filed by Wood Polymer Limited and Bengal Hotels Private Limited, respectively, under sections 391(2) of the Companies Act, praying for according sanction to a scheme of amalgamation of the afore-mentioned two companies. Wood Polymer Limited is public limited company and it is the transferee-company. Bengal Hotels Private Limited is a private limited company and is the transferor-company. The scheme submitted to the court for sanction involves amalgamation of the transferor-company with the transferee-company and amongst others it envisages dissolution of the transferor-company without winding up.

2. Transferor-company and transferee-company both filed separate Company Application Nos. 40 of 1974 and 41 of 1974, respectively, requesting the court to give directions for convening meetings of the creditors and members to whom compromise and/or arrangement was offered. In the case of the transferee-company, J. B. Mehta, J. by his order dated 23rd October, 1974, directed separate meetings of equity and preference shareholders and Unsecured creditors having a claim over Rs. 5,000 to be convened separately for approving with or without modification the scheme of compromise and/or arrangement. In the case of the transferor-company, direction given was that a meeting of the

members of the company be convened for approving with or without modification the compromise and/or arrangement offered to them. Mr. V. H. Thakore, then attached to this High Court as special officer, was appointed as chairman to preside over the meetings. After the meetings were held, the chairman submitted his report. Thereafter, both the transferor-company and the transferee-company filed separate petitions u/s 391(2) of the Companies Act, praying for according sanction to the compromise and/or arrangement, which involves a scheme of amalgamation of the transferor-company with the transferee-company. On the petitions being presented they were admitted and directions were given for usual advertisements.

3. The official liquidator was directed to submit his report as contemplated by the second proviso to section 394(1)(vi) in respected of the transferor-company. The official Liquidator has submitted his report dated 11th March, 1975. The official liquidator has stated in his report that Messrs. Manubhai G. Patel, chartered accountants, Ahmedabad, were appointed as agents of the official liquidator to scrutinise the books of accounts and other papers of the company to find out whether the affairs of the company have or have not been conducted in a manner prejudicial to the members or to public interest. The auditors appointed by the official liquidator examined the books of the accounts and other records thoroughly and submitted their report dated 10th March, 1973, to the official liquidator, a copy of which is annexed to the report of the official liquidator. While stating that the affairs of the transferor-company have not been conducted in a manner prejudicial to the interest of its members or public interest, it was pointed out by the auditors, and retreated by the official liquidator, that the transferor-company was merely created to facilitate the transfer of "Avenue House" which was once of the ownership of Dar Orango Chem Private Ltd. to the transferee-company so as to avoid payment of capital gains tax, which would otherwise be payable u/s 45 of the Income Tax Act. If the transfer of the Avenue House Property was to be brought about from Dar Orango Chem Private Limited (DOC Pvt. Ltd. for short) to the transferee-company, without the intervention of the transferor-company, in all probability, the original owner of the property would have become liable to pay capital gains tax to the tune of Rs. 10,88,776. It is in terms stated that in order to avoid this capital gains tax, the transferor-company was floated and the transferor-company has already availed of the benefit enacted in section 47 of the Income Tax Act. It is this part of the report of the official liquidator that has added an entirely new dimension to this otherwise routine run-of-the-mill application which would have been disposed of without much ado.

4. Salient features of the scheme of amalgamation of the transferor-company with the transferee-company may be noticed. The scheme envisages amalgamation of the transferor-company with the transferee-company and dissolution of the transferor-company without winding up. Incidental to this amalgamation, all the assets and liabilities of the transferor-company are being taken over by the transferee-company with effect from the appointed day, which

was specified to be close of the business hours on 31st day of March, 1973. The issued, subscribed and paid up capital of the transferor-company is Rs. 2 lakhs consisting of 2,000 shares of Rs. 100 each of which 1,800 shares were issued as fully paid for consideration other than cash. The entire issued capital of the transferor-company was held by DOC Pvt. Ltd. In other words, the transferor-company was a wholly-owned subsidiary company of DOC Pvt. Ltd. The scheme of amalgamation envisage extinguishment of the capital of the transferor-company on its dissolution to be brought about by exchange of its equity shares in the ratio of 20 equity shares of Rs. 100 each fully paid of the transferor-company for 900 equity shares of Rs. 10 each credited as fully paid of the transferee-company, as well as 170 convertible debentures bearing 8% interest each of Rs. 100 credited as fully paid to be issued by the transferee-company. The convertible debentures were to carry interest at the rate of 8 per cent. per annum and were redeemable at par in 1983-85 and would carry floating charges or second charges and only on the assets originally belonging to the transferor-company and shall not carry any charge on any other assets of the transferee-company. The holders of the debentures were given an option to convert the said debentures into equity shares of the transferee-company of Rs. 10 each at par fully paid, the shares of the transferee-company of Rs. 10 each at par fully paid, the option to be exercised from time to time and at any time for such portion or portions of the holdings of the said debentures as holder thereof may think fit during the accounting years 1976-77 and/or 1977-78 of the transferee-company. A member of the transferor-company was given a further option on his or her desire in lieu of the entitlement for exchange of shares or debentures to receive payment at the rate of Rs. 800 in respect of every equity shares of Rs. 100 each fully paid of the transferor-company held by him or her; and such option was to be exercised in the manner provided is the scheme. Other details are not necessary for the purpose of this judgment.

5. A notice of the admission of both the petitions was served on the Central Government as envisaged by section 394A of the Companies Act and a letter was received from the Joint Director (Accounts) on behalf of the Regional Director, Company Law Board, dated 19th April, 1975, whereby it was intimated to the court that the Central Government has decided not to file any representation with regard to the petitions for amalgamation.

6. When a scheme of compromise and/or arrangement is submitted to the court for its sanction, the court would ordinarily pose to itself the three questions, viz. (i) whether the statutory provisions have been complied with or not; (ii) whether the class or classes have been fairly represented; and (iii) whether the arrangement is such as a man of business would reasonably approve.

7. In respect of these three questions, there is absolutely no dispute between the parties. The members in the case of the transferor-company and unsecured creditors as well as equity and preference shareholders of the transferee-company have approved the scheme of compromise and/or arrangement offered

to them. The classes, looking to the report of the chairman, appear to have been adequately represented. There is not the slightest suggestion that the majority has coerced the minority into submission or is trying to take unfair advantage of the minority. The last question is whether the compromise and/or arrangement is such is one guided by instinct of preservation of one''s own interest, who brings to bear upon the subject his commercial judgment would accept it as fair and reasonable one. The only point in this behalf to be examined is the ratio in respect of which the shares of the transferor-company were to be exchanged for the shares of the transferee-company. Exchange ratio has already been set out above. M/s. Talbot & Co. had valued the assets of the transferor-company as on 2nd January, 1973, at Rs. 2 lakhs. Accepting the report as the basis for exchange of shares, the transferee-company agreed to allot 90,000 equity shares of Rs. 10 fully paid and 17,000 convertible debentures bearing 8 per cent. interest of Rs. 100 each fully paid in exchange for 2,000 equity shares of Rs. 100 fully paid of the transferor-company. There is an option to receive Rs. 800 per cent share in each. Let us see how it works out in reality. Avenue House is the only capital asset of the transferor-company and is valued at Rs. 26,00,000 at the relevant time. If it is sold and the purchase price is distributed amongst 2,000 shareholders each shareholder for his each share will get Rs. 1,300. If he opts for cash under the scheme he is paid Rs. 800 per share. If he opts for allotment of shares and debentures he gets 45 shares each of Rs. 10 fully paid and 8 1/2 debentures of Rs. 100 fully paid. Apparently, he gets shares and securities worth Rs. 1,300 per shares. But it may be noted that the equity share of Rs. 10 fully paid of the transferor-company was quoted in share market at Rs. 4.50 per share and one has no idea as to how the debenture would fare when put on stock exchange list. However, as neither the equity shareholders of the transferor-company on the equity and preference shareholders of the transferor-company have objected to the exchange ratio on the round of it being unfair or unjust though it gives such prima facie impression, nor has any one appeared at the hearing of these petitions in response to a public advertisement to put forth any controversy in this behalf, therefore, even though the conversion ratio has not been worked out on the valuation of the assets of the transferee-company and the transferor-company by any chartered accountant and does not appear to be satisfactory, yet, on that account, I would not reject the scheme of amalgamation as everyone concerned with it appears to have been satisfied with the conversion ratio offered in the scheme of amalgamation. If some grievance had been voiced in this behalf it would have been interesting to prove in depth this aspect. There is a serious and keen recent controversy on the fair shares in corporate mergers and take-overs ably analysed by Victor Brudeney and Marvin A. Chivelstein in their article in Harvard Law Review, December, 1974, wherein they suggest the legal standards the courts should apply in testing fairness of a merger more particularly between a parent corporation and a subsidiary. It is obvious that in such a situation, the terms are unilaterally imposed. One standard suggested in that the parent''s management be treated as fiduciary and subsidiary be treated as beneficiary. Approaching from this angle, the ratio is open to criticism on the ground of the unfairness but I would not reject the scheme of amalgamation on that account. The question then is whether once it is shown to the court, to whom petition u/s 391(2) is presented for according sanction to the scheme of amalgamation, that the requisite statutory formalities have been duly carried out, has the court no option or jurisdiction to reject the scheme or has it merely to rubber-stamp the scheme ? The court has discretion in this and it is not merely a rubber-stamp. This question is no more res integra and can be said to have been fairly concluded by a decision of this High Court in Bank of Baroda Ltd. Vs. Mahindra Ugine Steel Co. Ltd., P. D. Desai, J.) wherein it is observed as under :

"In view of the foregoing discussion it appears to me that the court cannot abdicate its duty to scrutinise the scheme with vigilance and act as a mere rubber stamp simply because the statutory majority has approved it and there is no opposition to the scheme in the court. So much weight cannot be attached to the view of the statutory majority as to require the court to mechanically put its imprimatur on the scheme. The court is not bound to treat the scheme as a fait accompli and to accord sanctions out whether it is a reasonable arrangement which can by reasonable people conversant with the subject be regarded as beneficial to those who are likely to be affected by it. In the pursuit of such inquiry, the court is not tied down by the any rigid principles or strait-jacket formulas and no enumeration contained in judicial decision of the factors which can be taken into account, however precise, can be treated as exhaustive so as to limit the scope of the inquiry which, having regard to varying circumstance, s might differ from case to case. The burden lies on the petitioner-company to show that the scheme of amalgamation is fair, reasonable, workable and such that a man of business would reasonably approve. The court would, of course, take into account the fact that it has been approved by a big majority vote, but it would not shirk its duty to scrutinise the scheme, especially when it involves amalgamation of large companies in which may interest are at stake."

8. Viewed from a slightly different angle, it would appear that power of such amplitude as is discernible from the provisions contained in section 391(2) is conferred on the court to achieve some definite purpose or object. It is more often said that section 391 to 396 constitute a complete code and the provisions are in a way derogatory to the law of contract. To illustrate, when compromise or arrangement is offered to a class of creditors and/or a class of members of the company, and if the offer is accepted by a statutory majority, and the court accords sanction to it, it would be binding on the dissenting minority. The result that can be achieved by the scheme can as well be achieved by compromise being offered to each member forming a class or each creditor forming a class, but in that event, it would be binding on those who become party to the agreement and the dissenting minority would not be bound by it. When a compromise or arrangement is offered to a class and is accepted by a statutory majority of that class, when sanctioned by the court, it would be binding on the dissenting minority. Now, when the court exercised the power conferred upon it

by section 391(2) for sanctioning the scheme of compromise or arrangement the court by its act is imposing the scheme on dissenting members of that class. Before taking such an action, it would be open to the court toe examine the scheme in proper perspective in its various manifestations and ramifications before imposing it on unwilling or dissenting members of the class. That being the position in law, the court obviously would have a discretion either to sanction or to refuse to sanction the scheme. It cannot, therefore, be said that merely because statutory formalities are duly carried out, the court has no option but to sanction the scheme. In other words, the court at that stage is not merely reduced to a rubber stamp.

9. Once it is held that the occur that a discretion in the matter even after it is satisfactory established that statutory formalities have been duly would immediately arise as to what is the ambit of the discretion of the court. It is well-established and calls for no discussion that the discretionary power has to be exercised in a reasonable manner. Whenever a statue confers power, it is indisputable that power is conferred to achieve some object. And the power has to be exercised towards achieving the object. While exercising power, the authority on whom the power is conferred must be guided by the consideration whether by exercise of the power, the objection sought to be achieved while conferring power would achieved or not. Exercise of discretionary power stands on the same footing. Whenever a court or authority is invested with discretionary power it is implicit therein that the power must be exercised reasonably, meaning thereby in a reasonable manner, and it must be exercised for the purpose for which it is conferred. In a very celebrated passage of Maxwell on Interpretation of Statues, 12th edition at page 148 there is the following observation :

"When," said Lord Halsbury L.C., "it is said that something is to be done within the discretion of the authorities .... that something is to be done according to the rules of reason and justice, not according to private opinion ... according to law and not humor. It is to be, not arbitrary, vague, and fanciful, but legal and regular. And it must be exercised within the limit, to which an honest man competent to the discharge of his office ought to confine himself."

10. The language of section 392 further reinforce the above conclusion that a very weighty discretionary power is conferred on the court while exercising power conferred by section 391(2). Section 392 provides that the High Court while sanctioning the scheme of compromise and/or arrangement may give such directions in regard to any matter or make such modification in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement. This power when properly exercised would enable the court to rectify or modify or add to a compromise or arrangement. To bring out the width an amplitude of the power by contract, it may be pointed out that while, our company law follows almost to a word corresponding provisions of the English Companies Act, the latter Act does not contain the provisions in pari materia with section 391(2)(b) and, therefore, in order to mitigate any difficulty

arising out of a suggestion that may be made while the scheme is being examined by the court to modify or rectify the scheme already approved by the creditors and/or members, the sponsor of the scheme is invested with the power of the scheme itself to accept the suggestion that may be made by the court. That apart, it is an undeniable fact, that the court had discretion to accept or reject the scheme, even when it is satisfactorily established that statutory formalities have been duly complied with, and the scheme of compromise and/or arrangement has been approved by statutory majority of class of members and/or members to whim it was offered. And this discretion of the court to accept or reject the scheme would be guided by the consideration that power is exercised to achieve the object or purpose for which it was conferred.

11. Reverting to the case on hand, the court is called upon the sanction the scheme of amalgamation of two companies, namely, the transferor-company and the transferee-company. The scheme of compromise and/or arrangement envisaged by section 391 takes with its sweep amalgamation of companies. Section 394(1)(a) makes a provision for amalgamation of companies by resorting to the provisions of section 391. In fact, section 396 confers powers on the Central Government to direct amalgamation of two or more companies into a single company, if it is satisfied that it is essential in the public interest to do so. Power u/s 396 can be exercised only if amalgamation is in public interest. This will have to be kept in view while considering the habit of discretionary power u/s 391(2) read with section 394 and the purpose for which it can be exercised. If a compromise or arrangement envisages amalgamation of any two or more companies, the court while sanctioning the compromise or arrangement can make provision for all or any of the matters set out in various sub-clauses of clause (b) of sub-section (1) of section 394. There are two provisos to section 394(1) and the second proviso is material of our discussion. It reads as under :

"Provided further that no order for the dissolution of any transferor-company under clause (iv) shall be made by the court unless the official liquidator has, on scrutiny of the books an papers of the company, made a report to the court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest."

12. The scheme of amalgamation, of which sanction is sought, contemplates dissolution of the transferor-company without winding-up. Consequent upon that prayer being made, the second proviso would come into play. The court is precluded from making an order for dissolution of the transferor-company unless the official liquidator has on scrutiny of the books and papers of the company made a report to the court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest. To comply with the requirement of the proviso, the court had given a direction that the official liquidator should after scrutiny of the books and papers of the transferor-company make a report to the court giving his opinion whether the affairs of the company have not been conducted in a manner prejudicial to

the interests of the members or to public interest. the official liquidator appointed a firm of chartered accountants to examine the books of accounts and other papers of the transferor-company and on the basis of the report of the auditors, has submitted a report to which reference has been made earlier.

13. In short, the report does say that except for one noticeable feature of the scheme of amalgamation, and subject to it, in his opinion, the affairs of the company are not shown to have been conducted in a manner prejudicial to the interests of its members or to public interest. The noticeable feature referred to in his report is that the transferor-company appears to have been merely created to facilitate transfer of a building called ''Avenue House'' once belonging to DOC Pvt. Ltd. to the transferee-company so as not to be liable for capital gains tax, which, if a subterfuge of the transferor-company was not resorted to, would have become payable in the amount of Rs. 10,88,776. If the court sanctions the scheme, the property ''Avenue House'' once belonging to DOC Pvt. Ltd. would stand transferred to the transferee-company without any liability to pay capital gains tax.

14. On the discussion and points canvassed the following further questions arise for re-examination :

(i) What was the legislative intent in introducing the second proviso to section 394 and what is its relevance while examining a scheme of amalgamation submitted to court for sanction ?

(ii) What is the ambit, scope and outer periphery of the concept of ''public interest'' as envisaged in the second proviso ?

(iii) Is the disclosed purpose per forth by the companies who have moved the court for sanction of the scheme or merger/amalgamation, relevant consideration or could the court probe and go behind the apparent purpose and ascertain the real purpose and take into consideration that purpose, so as to reach a conclusion that for such a purpose the court would not permit its process to be utilised if the purpose shown to be one which is opposed to public interest.

(iv) If, except tax benefit no other purpose for merger/amalgamation is disclosed or on probing, tax avoidance appears to be the major and only purpose for the scheme, could it not be said that the purpose is such that the court should not sanction the scheme on the ground that it is opposed to public interest ?

(v) Should the court by its process facilitate avoidance of the tax, even if it can be said that avoidance is legal and cannot be styled as evasion ?

15. A mere reference to the events leading to the formation of the scheme of amalgamation would bring out in bold relief the purpose behind the scheme of amalgamation and would provide a tell-tale evidence that the scheme of amalgamation is nothing but a device to defeat that payment of capital gains tax.

16. Let me first recapitulate those facts and then examine the ambit of public

interest in the second proviso. Dost Mohammad & Co. Pvt. Ltd. was a private limited company registered under the Companies Act, having its registered office at Calcutta. It had an immovable property styled as Avenue House situate in Calcutta City. Bengal Hotels Private Limited, the transferor-company, was incorporated on 23rd August, 1971. It issued, subscribed and paid up capital is Rs. 2 lakhs consisting of 2,000 equity shares of Rs. 100 each. These 2,000 equity shares of Rs. 100 each were held by Dost Mohammad & Co. Pvt. Ltd. whose name was subsequently changed to DOC Pvt. Ltd. At the relevant time the Avenue House which was the property of DOC Pvt. Ltd. was valued in its books at Rs. 1,80,717.79. This property was transferred to its wholly-owned subsidiary company, the transferor-company, for 1,800 equity shares of Rs. 100 each credited as fully paid allocated to DOC Pvt. Ltd., balance of Rs. 717.79 being paid in cash. Transfer by DOC Pvt. Ltd. to Bengal Hotels Pvt. Ltd. was by registered deed of conveyance dated 30th November, 1971. Now, this transfer by way of sale was by a holding company to its wholly owned subsidiary company at book value and, therefore, did not entail payment of any capital gains tax in view of the provision contained in section 47(iv) of the Income Tax Act, 1961, which provides that nothing contained in section 45 shall apply to .... (iv) any transfer of capital asset by a company to its subsidiary company, and (b) the subsidiary company is an Indian Company. Section 47(iv) was clearly attracted because all the shares of Bengal Hotels Pvt. Ltd. were then held by DOC Pvt. Ltd. and Bengal Hotels Pvt. Ltd. was an Indian company transfer was of capital asset by the holding company to its subsidiary company. After this transfer was effected on 30th November, 1971, at the book value, Bengal Hotels Pvt. Ltd. the transferor-company, got it valued by one Messrs. Talbot & Co. on 2nd January, 1973, and Avenue House property was valued at Rs. 26 lakhs. It would appear that within a span of 1 1/2 years only, the valuation rose form Rs. 1,88,717.79 to Rs. 26 lakhs. Scheme of compromise and/or arrangement between the transferor-company and the transferee-company was first mooted by the end of 1972, when the transferor-company received a proposal from the transferee-company that it, Wood Polymer Limited, for a scheme of amalgamation with the latter to which the entity undertaking, property, rights and powers and all assets, duties, obligations, and liabilities of the transferor-company were to be transferred without further act or deed to the transferee-company. Probably valuation by Messrs. Talbot & Co. is undertaken after the proposal for amalgamation was received form the transferee-company. The valuation report of Messrs. Talbot & Co. assumes considerable importance because it was submitted on 2nd January, 1973. The scheme of amalgamation was finalised between the two proposing companies and effective date was fixed as 31st March, 1973, that is, roughly within two months after the receipts of the valuation report of Messrs. Talbot & Co. in which the value of Avenue House property was put at Rs. 26 lakhs. The exchange ratio of shares has been determined on the valuation report. The official liquidator in his report under the second proviso clearly points out that on the valuation report made by Messrs. Talbot & Co. the transferee-company has agreed to allot 90,000 equity shares of Rs. 100 each and 17,000 convertible debentures bearing 8 per cent. interest of Rs. 100 each in consideration of 2,000 equity shares of Rs. 100 each of the transferor-company. Shorn of all embellishments, the Avenue Hose property which was of DOC Pvt. Ltd. and was valued at Rs. 1,80,717.79 on 30th November, 1971, when it was transferred by taking 1,800 shares each of Rs. 100 credited fully paid of the transferor-company, and within a span of 1 1/2 years DOC Pvt. Ltd. is getting shares and security worth Rs. 26 lakhs and the transferee-company is acquiring a property valued at Rs. 26 lakhs by paying Rs. 26 lakhs in shares and securities and the transferor-company is avoiding any liability to pay capital gains tax even though the property changed hands twice in a span of 1 1/2 years.

17. Section 45 of the Income Tax Act, 1961, provides for levy of capital gains tax on any profits or against arising form the transfer of a capital asset. Section 47 carves out an exception to section 45 meaning thereby that certain transactions specifically set out in section 47 are not to be treated as transfer for the purpose of section 45. Section 47(iv) provides for exemption form payment of capital gains tax on any transfer of capital asset by a holding company to its subsidiary company, if the conditions mentioned therein are satisfied. Advantage of this provision was taken when that Avenue House Property belonging to DOC Pvt. Ltd., the holding company, was transferred to Bengal Hotels Pvt. Ltd., transferor-company being a subsidiary company and the transfer was of capital asset. Sub-clause (vi) of section 47 grants exemption for payment of capital gains tax on the transfer in a scheme of amalgamation of capital asset by the amalgamation company to the amalgamated is an Indian company. The scheme envisages transfer of all assets including the capital asset of he transferee-company and capital asset is Avenue House and it is to be transferred to the transferee-company and the transfer-company is amalgamating company and it is an Indian company. As the transfer of capital asset is being brought about as an integral part of the scheme of amalgamation of amalgamating company with the amalgamated company is an Indian, company, transfer of the capital asset, namely, Avenue House, would again be exempt from the liability to pay capital gains tax.

18. DOC Pvt. Ltd. floated the transferor-company as its subsidiary company. The principal object for which the subsidiary company was floated was to set up a hotel at the premises of Avenue House, Chowringhee Square, Calcutta. In other words, the holding company floated a subsidiary company for starting business hotelier. The business was to be started in the property known as Avenue House then belonging to the holding company. The subsidiary company was incorporated in August, 1971, and the property, Avenue House, was transferred to the subsidiary company in November, 1971. No hotel business appears to have been ever started in the property known as Avenue Hose or anywhere else. For that matter, the subsidiary company appears not to have commenced any business. In passing it was mentioned that the transferor-company applied for a permission under the relevant regulations in force in Calcutta City from the Commissioner of Police, Calcutta, for starting a hotel in the Avenue House

property but the permission was refused. Barring this bare assertion, there is no material to show that new attempt was made to start the business in that property. Soon thereafter, the property was valued at 13 times more than the value at which it was transferred. And I was told that I would not look upon this aspect as very unusual, because in the world of commerce, transfer at book value is a normal Phenomenon. Reference in this contention was made to the Capital Issues (Exemption) Order, 1969. Clause 5 of this Order Provide for exemption for issue of securities other than debentures by certain public limited companies from the provisions contained in section 3 4 and 5 of the Capital Issues (Control) Act, 1947. There is a long proviso to this clause and sub-para. 4 of the proviso provides for the issue of securities by the company for the purpose of taking over an existing business or asset, and the take over is effected at the book value of such business or asset. I am afraid, clause 5 of the Capital Issues (Exemption) Order, 1969, could hardly be called in aid for the present discussion. The Order provides for exemption form the provisions one of the circumstances envisaged is where security is issued for the purpose of taking live an existing business asset and take over is effected at the book blue of such business. It is not for a moment suggested that that take-over of asset at book value is unknown in the world of commerce. The question really is whether that was a normal transfer of asset in the ordinary course of business or the transfer to a subsidiary company was a subterfuge or device to defeat the payment of capital gains tax, which could be payable, had the capital asset been transferred directly by DOC Pvt. Ltd. to which it belonged, to the Wood Polymer Ltd., the transferee-company, to whom it is sought to be transferred through a via the transferor-company and in the process the original owner company receiving Rs. 26 Lakhs worth of securities in respect of the property valued in its book at Rs. 1,80,717.79 without the slightest liability to pay the capital gains tax. That would be the point to ponder over.

19. Before we proceed further, it is necessary to lift the veil in respect of transferor-company and to see the realities behind the facade of corporate personality. The transferor-company, that is, Bengal Hotels Pvt. Ltd., was floated by Pranlal Bhogilal, Baldevdas K. Petal and Ambalal C. Patel. They are subscribers to the memorandum of association in which the first mentioned two persons, namely, Pranlal and Baldevdas, are shown as nominees of Dost Mohammad and Company Private Limited having its registered office at Calcutta. The registered office of the transferor-company was initially to be set up in the State of Maharashtra, but subsequently, by a special resolution confirmed by the High Court of Maharashtra, it was transferred to the State of Gujarat. As state earlier, the company was floated in the latter half of 1971. In the year 1972-73, Pranlal Bhogilal was the chairman of the board of directors of the transferee-company. In 1962, the shares of Dost Mohammad & Co. Pvt. Ltd. were disposed of by then members of the company and were taken over by the members of the transferee-company including Pranlal Bhogilal and his friends and relations, and thereafter name of Dost Mohammad & Co. Pvt. Ltd. was changed to DOC Pvt.

Ltd. The authorised capital of DOC Pvt. Ltd. was Rs. 50 lakhs out of which, issued, subscribed and paid up capital was of Rs. 28 lakhs consisting of 28,000 equity shares of Rs. 10 each fully paid, 1,50,480 "A" preference shares of Rs. 10 each fully paid and 1,26,720 "B" preference shares of Rs. 10 each fully paid. The total issued and subscribed capital was thus of Rs. 28 lakhs. It was held by Ambalal C. Patel, his brother, Thakorelal C. Patel, Bhogilal H. Patel, his son, Pranlal, Bharatidevi, daughter-in-law of Bhogilal, Kashyap, son of Ambalal Patel, as individual shareholders and the four companies, namely M/s. I. B. Model Farm Pvt. Ltd. the Navbharat Finance Corporation Pvt. Ltd., Oriental Estate and Mfg. Pvt. Ltd. and Modern Bobbin Co. P. Ltd., and it is admitted that in all the aforementioned four companies, Pranlal Bhogilal is the owner as the majority shares of them are held by his friends and relations. These companies and Dost Mohmad & Co. Pvt. Ltd. are appropriately described as companies belonging to Bhogilal group. On a proper analysis, at the relevant time, Ambalal Patel and Pranlal Patel with their friends and relations held all the issued, subscribed and paid up capital of DOC Pvt. Ltd. DOC Pvt. Ltd. held all the shares of Bengal Hotels Pvt. Ltd. the transferor-company. Pranlal has a large shareholding in the transferee-company. Both Pranlal Patel and Baldevdas as nominees of Dost Mohmad & Co. Pvt. Ltd. and the third person, Ambalal Patel, floated the transferor-company with its registered office first in Maharashtra and then in Gujarat. To repeat, Dost Mohmad & Co. Pvt. Ltd. held all the shares of Bengal Hotels Pvt. Ltd. through their holding of all shares of Doc Pvt. Ltd., and Pranlal has a large interest in Wood Polymer Limited, the transferee-company, and is the chairman of the transferee-company. Virtually it comes to this that Pranlal and his associates first acquired DOC Pvt. Ltd. and then floated Bengal Hotels Pvt. Ltd. so as to transfer the Avenue House from Dost Mohmad & Co. Pvt. Ltd. to its subsidiary, Bengal Hotels Pvt. Ltd., i.e., from himself to itself and, then, in turn, has suggested a scheme of amalgamation of Bengal Hotels P. Ltd. with Wood Polymer Ltd. from his left had to his right hand. In other words, DOC P. Ltd. i.e., Pranlal and his friends and relatives, could sell Avenue House to Wood Polyer Ltd., wherein they have substantial interest through the transferor-company, solely created as paper company, a fiction of law or a fictituous personality to bring about this transfer which if undertaken directly would straightway invite application of section 45 of the Income Tax Act. It would, in this connection, be advantageous to recall the words of Denning M.R. in Wallersteiner v. Moir [1974] 3 All ER 217, examining the contention that the various concern set up and controlled by Dr. Wallersteiner were his alter ego or himself wearing another had and it was a fit case to pierce the corporate veil. It was observed that these different concerns were the puppets of Dr. Wallersteiner. He controlled their movements. Each danced to his bidding. He pulled the strings. No one else got within their reach. This is equally true of Pranlal, his friends and relatives and the conclusion is inescapable that the transferor-company was a paper creation, a large fiction set up for transferring capital asset from Doc Pvt. Ltd. to the transferee-company without attracting the capital gains tax liability.

20. It was very strenuously urged that it is not open to the court to crack the shell of corporate personality and life the veil and look behind the realities because since the Salmon''s case [1897] AC 22 (HL), this proposition is unquestionably established that the corporation is a legal entity distinct form its members. More often the words of Lord Halsbury in Solomon v. Salomon & Co. Ltd. [1897] AC 22, 51 (HL), were referred to assert that a limited company was legal entity independent of those who formed it. In his celebrated passage Lord Macnaghten observed that :

"The company is at law a different person altogether from the subscribers ... and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act."

21. Incorporated company is a legal entity having a legal personality and is described as an artificial person in contrast with a human being, a natural person. By fiction of law it has been attributed aspects of a human being, it can sue and be sued, it has a perpetual succession, it can own and dispose of property and so on. But over a period of the abuses of this corporate personality became apparent. The courts have lifted the veil in order to see that corporate personality is not blatantly used as a cloak for fraud or improper conduct. In United States v. Milwaukee Refrigerator Transit Co. [1905] 142 Fed 247, the law on the point was summed up as under :

"A corporation will be looked upon as a legal entity as a general rule ... but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons."

22. The court should disregard separate legal personality of a company and ascertain who are in control of the company because in doing so there was an overriding public interest to be served. Ordinarily corporate personality is to be respected, but when a benefit is misused, the court is not powerless and it can lift the veil of corporate personality to see the realities behind the veil because is so doing, the court subserves the important public interest, namely, to arrest misuse or abuse of benefit conferred by law. One such filed in which the court lifts the veil and looks behind the realities is the field of taxation. Professor Gower in his treatise, Modern Company Law, 3rd edition, says that only trusted creditor in whose favour Slomon rule has been substantially mitigated is the revenue. In Bank Voor Handel en Scheepvaart N. V. v. Slatford [1951] 2 All ER 779,799, (KBD), Devlin, J. has observed :

"No doubt, the legislature can forge a sledgehammer capable of cracking open the corporate shell, had it can, if it chooses, demand that the courts ignore all the conceptions and principles which are at the root of company law."

23. In the field of taxation, the legislature has done precisely the same thing.

24. If the veil is lifted in this case, the realities are startling. Pranlal and his friends and associates first established control over DOC Pvt. Ltd. by taking over all its shares and with the use of its asset, namely, Avenue House, created a subsidiary company, transferred its capital assets to its wholly owned subsidiary company, namely, the transferor-company, and after transfer of the assets got it revalued and then this subsidiary company did not do any business and in fact I am more than certain that it was not expected to do any business; and, thereafter, the subsidiary company was sought to be amalgamated with the Transferee-company, in which Pranlal and his friends and relations have a substantial interest as they are holding all the shares of DOC Pvt. Ltd. that benefited to the tune of Rs. 24 lakhs and by taking the shares of the Transferee-company in the scheme, increased their octopus hold on the transferee-company. To again quote Professor Gower, it has become a habit to create a pyramid of inter-related companies, each of which is theoretically a separate entity but in reality part of the concern represented by the group as a whole. If the transferor-company was a paper creation of those who were in charge of the company, who created a transferor-company, as a wholly owned subsidiary company and used it as a medium to transfer its capital assets to the transferee-company and in the process enriched itself by defeating capital gains tax to the tune of Rs. 10 lakhs and more and if that is the only purpose to be achieved by the scheme of amalgamation, should the court be a party to this device by approving such a scheme of amalgamation ? The question thus posed by the court enlarges the field of enquiry with regard to the issue of public interest raised in this petition and covers a large field.

25. Learned Advocate General who appeared both on behalf of the transferor-company and the transferee-company contended that, taken at its face value, the report of the official liquidator is clearly in favour of the transferor-company when it proceeds to state that the affairs of the transferor-company are not conducted in a manner prejudicial to the members or public interest. It as said that on that averment, it can be said that the requirement of the proviso has been complied with and the court should not further prove into the matter. The report of the official liquidator is subject to an important factual statement, namely, that the transferor-company was a paper company only created for the purpose of acquiring Avenue House property without incurring any liability to pay capital gains tax. The liquidator was called upon to inquire whether the affairs of the transferor-company have been carried on in a manner prejudicial to the members of the company or public interest. Now, the report clearly recites that the affairs are not shown to have been carried on in a manner prejudicial to the members of the company. But, if it is shown that the transferor-company was a paper company, created for the purpose herein mentioned, could it be said that its affairs were carried on in a manner not prejudicial to public interest ? An attempt was made to urge that inquiry under the second proviso is limited to carrying on affairs of the company, meaning thereby, carrying on of the business

or the management of the company, in other words, its internal affairs and it has nothing to do with the broader perspective of creation of company for a purpose and achieving that purpose by mere creation of the company, purpose being to defeat the payment of capital gains tax. The language of the second proviso does not admit of such narrow construction. What is meant by the expression "carrying on the affairs of the company" ? It involves setting up of the company, floating the company, carrying on business of the company, is internal working, its working in relation to the socio-economic set up of the society and the way in which it treats its members and creditors, all these will be included in the expression "affairs of the company". The expression "affairs of the company" need not be given restricted meaning, namely, "the internal working of the company." The expression "affairs of the company" must take colour from the expression of "public interest" : used in the proviso. The query which the court must address itself is : whether the affairs of the company have been in a manner prejudicial to the public interest ? The expression "affairs of the company" must receive wider construction in view of the fact that they are to be examined in relation to public interest. Therefore, it is not possible to accept the submission that the expression "affairs of the company" must receive a narrow construction so a to confine it to internal management of the company itself. The question that should be fairly posed is : whether it is shown that the affairs of the company have not been carried on in a manner prejudicial to the public interest ?

26. What then is the concept of "public interest" in company law. In the heydays of laissez faire, it was quite well-known for the leaders of trade and industry not only to ignore but disavow public interest involved in carrying on business. Their sole attention was confined to the interest of creditors and members. But other important consumers of industry-cum-commercial service were wholly ignored, namely, employees and consumers of the goods produced by the industry, I mean, the society. It would be interesting to recall the remarks of Correlius Venderbilt, the then Chairman of the New York Central Rail Road, in the course of a celebrated controversy over the ruthless commercial policy followed by the Raol Road Company, when replying to a newspaper criticism of this policy, he openly declared - "the public be damned". (vide The Concept of Public Interest in the Indian Company Law by D. L. Mazumdar I.C.S., quoted in The chartered Accountant, vol. XII part I, 1963-64, p. 406.) the concept of public interest has recently received recognition in the business practice of the more enlightened sections of the leaders in the trade and industry. As far as our Companies Act is concerned, it has received statutory recognition in sections 89(4) 205(1) 211(3) 221 244(1), 250, 303,326,352 and 396 in the Companies Act. "Public interest" is a positive check on unhindered exercise of private right whether by management or stock-holders. Our company law has recognised the fact that there are several areas in this field where even the joint will of the management and the stock-holders must give way to the requirements of public policy. In the field in which public interest is recognised as a relevant consideration, freedom of management

and stock-holders to carry on the business of the company in regard to these matters, in such manner as they like, has been specifically subjected to the condition that autonomous decision making in these areas must not override the concept of the public interest (vide D. L. Mazumdar I.C.S. supra).

27. The expression "public interest" : is sometimes used as an expression inter-changeable for the national interest. This is a term very often used in contradistinction to "private interest" or "personal interest". It is something in which the public, the community at large, has some pecuniary interest, or some interest by which their legal rights or liabilities are affected (vide Black''s Dictionary, 4th edition, p. 1393). The word "public" has a very wide connotation, and though the word "public" has a very wide connotation, the perspective in which it is used will determine its ambit. The expression "interest of the general public" came in for construction in Emperor v. Jesingbhai [1948] 50 Bom LR 544 , wherein it was held that it is an expression of wide connotation and has got several implications. As the expression will take its colour from the context in which it is used, the object behind the legislative intendment within which it is used and the mischief it seeks to suppress, all these factors will enter into the verdict in deciding what constitutes ''public interest'' in the context of the legislation in which it is used. In the very nature of the case, modern conditions and the increasing inter-dependence of the different human factors in the progressive complexity of a community make it necessary for the Government to touch upon and limit individual activities at more points than formerly. The State of Bihar Vs. Sir Kameshwar Singh, . In the context in which the court is called upon to examine whether the affairs of the company were carried out in a manner prejudicial to the members of the company or public interest, it would be necessary to determine the wider philosophical context why the State is permitted to levy tax. It is not necessary for me to dive deep into the philosophy of taxation. Suffice it to say that all the taxes are levied by the State in public interest. No tax is levied for merely enriching the Sate or for the private use of some private individual. The State represents the common will and is devoted to common good and all powers are conferred on the State for achieving common good. That is equally true police powers of the State. For carrying out all the activities expected of a welfare State, the State must have funds and to get them, it has to levy taxes. It would, therefore, be indisputable that taxes are levied for the common good and that would indisputably be in public interest. If such be the philosophy behind the taxing power of the State, could it be said that when by a device resorted to, in which success can be achieved with the aid of the court, a subject seeks to defeat tax, such action could even be in public interest ?

28. It was incidentally said that in the context of the Monopolies and Restrictive Trade Practices Act, the test for determining "public interest" : would be properly covered in the second limb of the dictum of Lord Macnaghten in Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co. [1894] AC 535 (HL). Before I examine the test, I should like to make it clear that passage relied upon opens

with words "the true view in the present time, I think, is this" and the present time has relation to the role of the State in England in 1894, economic doctrine of laissez faire, then prevalent, and apart from anything else. I have my grave doubt whether that test is valid in the context of the welfare State and egalitarian society sought to be set up under our Constitution. With this limitation, the second limb of the test formulated in that case may be examined. It says that all interference with individual liberty in action in trading, and all restraints in themselves, if there is nothing more, are contrary to public policy, and therefore, void. That is said to be the general rule and exceptions are thereafter noticed, restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is sufficient justification and, indeed, it is the only justification, if the restriction is reasonable - reasonable, that is, in the interest of the parties concerned and reasonable in the interest of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public. In Restrictive Trade Practice and Monopolies, second edition, by Lord Willberforce and others, page 272, it is observed that Lord Mansfield states that the principle of public policy is that ex dolo malo non oritur actio : thus on court will lend its aid to a man who founds his cause of action upon an immoral or illegal act. Dolus malus, immorality or illegality determine illegality or invalidity because of public policy. In the context of section 21 of the English Restrictive Trade Practices Act, the question of public interest has to be examined by the test enacted in the section itself. However, when it comes to the court to decide whether certain agreement is in public interest or opposed to public interest, a broader test was formulated of specific and substantial benefit to achieve, enjoy, or likely to be enjoyed by the public. It is not necessary to prove this argument further because the concept of public interest takes its own colour in providing its own inherent yardstick by reference to the context in which the expression is used, the statue in which it is used and purpose sought to be achieved by the use of the expression.

29. It was very strenuously urged that if a statute permits a thing to be done, doing of it in that manner could never be against or contrary to public interest. It was said that if section 47(iv) exempts a transfer of capital asset by holding company to its subsidiary company, or u/s 47(iv) transfer of capital asset by the amalgamating company to the amalgamated company in a scheme of amalgamation is exempt from the levy of capital gains tax, doing of which is permitted by law, the same could never be said to be against public interest, and, therefore, the court should not look upon it with an eye of suspicion. Undoubtedly, for the purpose of section 45 of the Income Tax Act, those transactions enumerated in section 47 would be exempt from the operation of section 45. That would include transfer of capital asset by the holding company to the subsidiary company or vice versa, or transfer as part of the scheme of amalgamation of the capital asset of the amalgamating company to the amalgamated company. In the latter case, however, the scheme of amalgamation

can only be operative and binding if it is sanctioned by the court. The power to sanction a scheme is converted on the court. Scheme of amalgamation may have to be framed for achieving some object or purpose. Companies do not amalgamate for the fun of it. They must amalgamated or would like to amalgamate or may be amalgamated to achieve some purpose or object. By section 396 power is conferred on the Central Government to amalgamate two companies if it is in public interest. Section 396 is in the same part in which sections 391 onwards find their place. Section 396 is the legislative exposition of the purpose behind the provision conferring power on the court or the Central Government to sanction amalgamation in one case or to direct amalgamation, namely, it must be exercised in public interest. Amalgamation must accordingly fulfill some felt need, some purpose, some object and that must have some correlation to public interest. If the only purpose discernible behind the amalgamation is defeating certain tax and prior to the amalgamation a situation as brought about by creating a paper company and transferring an asset to such company which can without further consequence be amalgamated to another company to whom the capital asset was to be transferred so that on amalgamation it can pass on to the amalgamated company, it would distinctly appear that the provision for such a scheme of amalgamation was utilised for the avowed object of defeating tax.

30. It was, however, urged that if the parties so arranged their affairs as would result in diminution of the tax liability, that may amount avoidance of tax and not evasion of tax and law frowns upon the tax evasion and not on tax avoidance. Number of paragraphs were read over to me from "Adopt Avoidance and Avoid Evasion" by S. R. Loonekar, 1972, edition. It was said that in a tax law, morality has no place and it is a strict rule of fiscal law that has to prevail. In Commissioner of Income Tax, Gujarat Vs. A. Raman and Company, it was observed as under :

"Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income Tax Act. Legislative injunction in taking statues may not except on peril of penalty, be violated, but it may lawfully be circumvented."

31. In Commissioner of Income Tax Vs. Sakarlal Balabhai, , it was observed as under :

"Tax avoidance postulates that the assessee is in receipt of amount which is really and in truth his income liable to tax but on which he avoids payment of tax by some artifice or device. Such artifice or device may apparently show the income as accruing to another person, at the same time making it available for use and enjoyment to the assessee as in a case falling within section 44D or mask the true character of the income by disguising it as a capital receipt as in a case falling within section 44E or assume diverse other forms ... But there must be some artifice or device enabling the assessee to avoid payment of tax on what is really and in truth his income. If the assessee parts with his income producing asset, so that the right to receive income arising from the asset which therefore belonged to the assessee is transferred to and vested in some other person, there is no avoidance of tax liability : no part of the income from the asset goes into the hands of the assessee in the share of income or under any guise."

32. This view of the Gujarat High Court, I was informed, has been subsequently confirmed by the Supreme Court. My attention was also drawn to the Law and Practice of Income Tax by Palkhivala, 7th edition, in which it is stated that the subject has the legal right so to dispose of his capital and income as to attract upon himself the least amount of tax. Avoidance of tax is not tax evasion and it carries no ignominy with it, for it is sound law and, certainly, not bad morality for anybody to so arrange his affair as to brunt of taxation to a minimum. In Lilly v. Commissioners of Internal Revenue 27 ALR 492, the question arose whether the deduction from the Income Tax returns of the proprietor of the retail optical store of payment to physicians of the one-third of the sales price of glasses sold to their patients was claimed as an ordinary and necessary payment within the meaning of the relevant section of the Internal Revenue Code. The tax court did not uphold such deduction and the matter was brought to the Supreme Court wherein it was observed that deductibility of such payments, although they are not to be approved as a matter of business ethics, cannot be denied on grounds of public policy, there being no clearly defined law or policy against them at the time particularly in view of the retroactive hardship involved if they are disallowed. It was further observed that the state does to seek to regulate or improve trade practice and customs as they are reflected in the operating costs of a business nor does it seeks to penalise under legal practices and customs by disallowing expenses which they entitle and taxation more than commercial net income. Question of public policy or public interest was examined in the context of the state under which the problem was brought before the court and I was specifically asked to note that the problem arose under the taxing statue. It was urged that even if a certain payment may appear to the court to be improper, if not immoral, yet that should not be the guiding consideration for examining them in the context of public interest. It was further contended that the provisions of the Companies Act are not enacted for the purpose of getting more tax for the Government and concept of "public interest" : may be examined the context of the company law. Reference was made to Escoigne Properties Ltd. v. Inland Revenue Commissioners [1958] AC 549 (HL). Section 42 of the Finance Act, 1930, granted exemption to stamp duty on an instrument to which the section applied. One such instrument compromise in the interest in property from one company with limited liability to another such company; and one of the companies is beneficial owner of not less than 90 per cent. of the issued share capital of the other company. By section 50(1) of the Finance Act, 1938, it was provided that section 42 of the Finance Act, 1930, shall not apply unless it is whom to the satisfaction of the Commissioners of Inland Revenue that the

instrument was not executed in pursuance of or in connection with an arrangement where under certain things were provided for. A question arose whether certain instrument were exempt from payment of stamp duty as they would fall u/s 42 of the Finance Act, 1930. Rejecting the claim for exemption from stamp duty it was held that the object of section 50 was to put a stop to that device; and it succeeded. If that meaning is not given all that would be necessary would be to incorporate two puppet companies, make the contract in the name of one and take the conveyance in the name of the other, and no stamp duty would be payable. In such a situation, the House of Lords referred to Heydon''s case [1584] 3 Co. Rep 7a, 7b and observed that such construction should be put on the provisions of a status shall suppress the mischief, and advance the remedy and the words of Lord Selborne L.C. in Caledonian Railway Co. v. North British Railway Co. [1881] 6 App Cas 114, 122, (HL), that the more literal construction ought not to prevail if it is opposed to the intention of the legislature as apparent by the statue, were recalled. It was further observed that the case is not one of literal construction versus liberal construction, it is rather a case of remembering that every statute must be read in the light of the circumstances in which it was made and the object it was supposed to achieve.

33. Lastly, I would refer to Ransom v. Higgs [1974] 3 All ER 949 (HL). In that case, certain expenditure was claimed as deductible as having been incurred for the business of the company. The finding of the Commissioner was that the expenditure had been incurred in part for the purpose of facilitating tax avoidance, and the same was considered fatal to the claim since that purpose was not a trading purpose and accordingly the expenditure had not been incurred wholly and exclusively for the purpose of trade. However, this decision was read also to point out that apart from admissible deductions, the view has been taken in this case that if the numerous companies were formed so as to create certain tax benefit, that in itself was not considered sufficient to deny the benefit that accrued from the formation of companies created for the sole purpose of enjoying tax benefit. That may be true but the question which is under examination is : whether such benefits can be permitted to be enjoyed when it could not be done without the aid of the court. That questions does not appear to have been raised in the case under discussion. Similar is the position in Rodwell Securities v. Inland Revenue Commissioners [1968] 2 All ER 257. The benefit of exemption from the stamp duty was denied on the construction of statute granting exception but the following observation was relied upon in support of the submission that a mere setting up of a chain of companies is to open to lurking suspicion, that it has been done with an avowed object of defeating taxing statute. The observation relied upon reads as under :

"It is worthwhile observing that where you have a chain of companies it is always possible by arranging the transfer in a certain way, to obtain the benefit of exemption under the section."

34. It cannot be said that this observation had laid down a broad proposition of

law. The observation cannot be torn out of context and when read in the context, it only means that an arrangement can be made by the assessee is as it incur the least liability for the tax and to such proposition, I do not take any exception.

35. The expression "public interest" standing by itself is likely to appear to be vague without any specific connotation. It is capable of more than one meaning. Therefore, in order to ascertain the true meaning of "public interest" used in a given statute, it is to be construed in the context of the legislation in which it is used, provision in which it is used, and the purpose sought to be achieved by the use of the expression. Where alternative constructions are equally open that alternative is to be chosen which will be consistent with the smooth working of the system which statue purports to be regulating and that alternative is to be rejected, which will introduce uncertainty, friction, or confusion into the working of the system : vide Shannon Realities v. St. Michel [1924] AC 185 (PC). At any rate, such as expression capable of more than one meaning must draw is colour and content from the context in which it is used. It such should be the constriction of the expression "public interest", it would be necessary to see the setting in which it is placed. To recall earlier controversy "public interest" in company law is a new and recent entrant. The second proviso to section 394(1) was added by Amending Act of 1965, pursuant to the recommendations of Vivian Bose Commission of Dalmia and Jain concerns. The Vivian Bose Commission was appointed to inquire into and report on the administration of certain companies controlled by Shri Ramkrishna Dalmia and Shantiprasad Jain and two others and especially about the irregularities fraud or breaches of trust or action in disregard of honest commercial practices, contravention of any law (except contravention in respect of which criminal proceedings were pending in a court of law) in respect of the companies and firms covered by the terms of reference. Commission was also directed to suggest the action which in the opinion of the Commission should be taken to act as a preventive in future cases and also to suggest measures which in the opinion of the Commission are necessary in order to ensure in the future that due and proper administration of the funds and assets of the companies and firms in the interest of investing public. Interest of the investing public is interest of general public which expression would be covered by "public interest". Pursuant to this directive and as a consequence of its finding, the Commission recommended introduction of a provision by which the court while examining the scheme of amalgamation, would have an opportunity to ascertain whether the affairs of the transferor-company which will be dissolved without winding up were carried on in a manner prejudicial to its members or public interest. This recommendation found its echo in the second proviso to section 394(1). Apart from the recommendation, the voluminous report of the Commission throws a lurid light on how the machinery of company formation and company management were used to subserve the interest of those controlling the affairs of the company with scant regard for the interest of the society or event of the investing public.

36. The expression "public interest" is to be found in the second proviso and in

the context of a company which, if, scheme of amalgamation is sanctioned, is likely to lose its identity by getting merged with the transferee-company. It is to be dissolved without winding up. In winding up the manner in which affairs of a company are conducted can be probed in depth; but a scheme of amalgamation which provides for merger of the transferor-company with the transferee-company, would destroy any opportunity for examination of the affairs of the transferor-company. The second proviso would provide the last opportunity to peep into the affairs of the transferor-company before it gets virtually extinct. The court is, therefore, charged with a duty before it finally the confirms burial-cum-cremation of the transferor-company, to peep into its affairs to ascertain whether they have been carried on not only in a manner not prejudicial to its members but in even public interest. The expression "public interest" must take its colour and content from the context in which it is used. The context in which the expression "public interest" is used should permit the court to find out why the transferor-company came into existence, for what purpose it was set up, who were its promoters, who were controlling it, what object was sought to be achieved through creation of the transferor-company and why it is now being dissolved by merging it with another company. All these aspects will have to be examined in the context of the satisfaction of the court whether its affairs have not been carried on in a manner prejudicial to public interest. That is the colour and content of the expression "public interest" as used in section 394(1), second proviso, and the facts of this case will have to be examined keeping in view the colour and content of the expression "public interest".

37. The scheme of amalgamation must have some purpose or object to achieve. It was repeatedly inquired what purpose or object was to be achieved by a scheme of amalgamation offered for court''s sanction. It was said that the property belonging to the transferor-company will be available to the transferee-company. Now, the property belonging to the transferor-company is situate in Calcutta. The transferor-company is having its factory at Billimoria. The transferor-company appears to have not done any business except acquiring capital asset from its parent company of which it was a subsidiary company and got it revalued so that by the process of revaluation, the equity shareholders of the transferor-company can get large number of shares of the transferee-company by the exchange ratio prescribed in the scheme of amalgamation. No apparent understandable purpose or object behind the scheme is discernible. The purpose and the only purpose appears to be to acquire capital asset of the DOC Pvt. Ltd. through the intermediary of the transferor-company which was created for that very purpose to meet the requirement of law, and in the process to defeat tax liability that would otherwise arise. If such be the scheme of amalgamation and if such is the use made of the transferor-company by those controlling it, it can never be said that the affairs of the transferor-company sought to be amalgamated, created for the sole purpose of facilitating transferor capital asset, through its medium, have not been carried or in a manner prejudicial to public interest. Public interest looms large in this background, and

the machinery of judicial process is sought to be utilised for defeating public interest and the court would not lend its assistance to defeat public interest, namely, tax provision.

38. It must be confessed that it is open to a party to so arrange its affairs so as to reduce its tax liability. The assessee or party can arrange its affairs so that he or it may not incur any tax liability. But it must be within the power of the party to arrange its affairs. If the party seeks assistance of the court only to reduce tax liability, the court should be the last instrument to grant such assistance or judicial process to defeat a tax liability, or even to avoid tax liability. If the party has so arranged its affairs, as to reduce or even avoid tax liability and the taxing authority disputes it, and the matter is brought before the court, the court would adjudicate upon the dispute between the revenue and the assessee on the rival contentions. That is not the situation here. In such a situation, the court would not be concerned as to the modality of avoidance of tax but there the tax cannot scheme of amalgamation. In other words, the judicial process is used or polluted to defeat the tax by forming an appropriate device or subterfuge. Such a situation can never be said to be in public interest. It is clearly opposed to public interest and on this ground the court would not sanctions the scheme of amalgamation.

39. Accordingly, Petition Nos. 10 of 1975 and 12 of 1975 are rejected. As the Central Government after notice did not appear, Mr. V. B. Patel was appointed by the court to assist it in unraveling the implications of law in this case and it is reasonable that he should be paid his fees by the petitioners.

40. Accordingly, the petitions are dismissed with costs.

41. Petitions dismissed.

