IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

SPECIAL CIVIL APPLICATION No. 12254 of 2002

For Approval and Signature:

HONOURABLE MR.JUSTICE AKIL KURESHI
HONOURABLE MS.JUSTICE HARSHA DEVANI

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge?

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PRAVINBHAI M KHENI - Petitioner(s)
Versus
ASSTT.COMMISIONER OF INCOME TAX CENTRAL CIRCLE-2 & 2 - Respondent(s)

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Appearance :
MR JP SHAH for Petitioner(s) : 1,
RULE SERVED for Respondent(s) : 1 - 3.
MR MB PURABIA for Respondent(s) : 1,
MR TANVISH U BHATT for Respondent(s) : 1,
MR SUDHIR M MEHTA for Respondent(s) : 3,

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CORAM : HONOURABLE MR.JUSTICE AKIL KURESHI
and
HONOURABLE MS.JUSTICE HARSHA DEVANI

Date : 06/11/2012

ORAL JUDGMENT

(Per : HONOURABLE MR.JUSTICE AKIL KURESHI)

1. The petitioner has prayed for quashing the recovery proceedings undertaken by the

respondents against the petitioner for the income tax dues of M/s. M. Kantilal and Co. Ltd.,Surat. The petitioner has challenged orders Annexure-G, J and O passed by the respondents in this respect.

2. We may notice facts in brief.

2.1) The petitioner is a director of a private limited company M/s. M. Kantilal & Co. ltd.(here-in-after referred to as “the company”). On 7.1.1999 there were search proceedings on the company under section 132 of the Income Tax Act, 1961(“the Act” for short). Pursuant to such operations, block assessment under section 158BC of the Act was framed on 23.3.2001 computing total income of the company at Rs.259,22,64,020/-. The company preferred an appeal before the Commissioner(Appeals) who by his order dated 18.9.2002 reduced the computation of total income to Rs.130,54,95,443/-.

2.2) On the ground that the tax could not be recovered from the company, the respondents initiated proceedings under section 179 of the Act against the petitioner. On 13.9.2001, the Deputy Commissioner of Income-tax issued a notice to the petitioner stating as under :

“2. As a result of passing block search assessment order of M/s. M. Kantilal & Co. Ltd., on 23.3.2001, a demand of Rs. 155.33 crores is outstanding as on today. After giving proper

opportunity to this company, coercive measures as per I.T. Act has been initiated. The company has defaulted in making the payment. From the records it is ascertained that you are one of the Directors of this Pvt. Ltd. Company for the block period. Therefore as per the section 179 of the I.T. Act, you will be jointly and severally liable for the payment of the outstanding demand of M/s. M. Kantilal & Co. Ltd.

3. Please explain as to why recovery proceedings should not be initiated against you in the light of section 179 of the I.T. Act for the outstanding demand of the Company M/s. M. Kantilal & Co. where you are one of the directors.

4. Your reply must be received in my office within 3 days of the receipt of this notice. In case of non-receipt of your reply from your side, it will be construed that you do not have say anything in this regard and further recovery action as per I.T. Act will be resorted. Expecting Cooperation from your side."

2.3) In response to such notice, the petitioner replied under communication dated 20.9.2001. The petitioner opposed any recovery from him on the ground that the said company was a public limited company duly incorporated under the Companies Act, 1956. Provisions of section 179 of the Act would be applicable only where tax is due from a private company and, therefore, no recovery against the petitioner under section 179 of the Act can be made for dues of the said company.

2.4) The Assistant Commissioner of Income-tax however, passed the impugned order Annexure-G on 15.4.2002 and disregarded the petitioner's

objections. He noted that the company was subjected to search operation pursuant to which by the appellate order for the block assessment under section 158BC of the Act, tax liability of the company was determined at more than Rs.155 crores. He outlined the efforts made for recovery of such tax dues from the company by issuance of several notices, by issuing attachment orders and by proceeding under section 281 of the Act, despite which, no recovery could be made from the company. He therefore, concluded that “from the above actions taken it is apparent that recovery of tax cannot be made from the company.” He thereupon proceeded to examine the petitioner's objection with respect to non applicability of section 179 of the Act. He overruled such objections observing :

“The matter has been examined for the attachment of stock of rough and polished diamonds, which is around Rs. 5.00 to 6.00 crores. The TRO., Central Range, Surat is pursuing the matter for the attachment of said stock. Even after the attachment of the said stock of diamonds there would be huge demand of around Rs. 150.00 crores of tax dues to be paid by the assessee company. The Balance Sheet of the company has been analyzed, and it is found that the said undisclosed income has not reflected in the accounted Balance Sheet of the assessee company. Even the immovable property is not in the name of the company where the unaccounted income might have been invested. Therefore, it is apparent that the unaccounted income of the company has been misappropriately utilised by the Directors and Shareholders of M/s M Kantilal & Co. Ltd.

A Memorandum of Association of M/s M Kantilal & Co. Ltd. Has been analyzed. The

following are the directors/shareholders of M/s M Kantilal & Co. Ltd :-

[1] Shri Manjibhai Mavjibhai Patel
[2] Shri Pravinbhai Mohanbhai Kheni
[3] Shri Kantibhai Mohanbhai Kheni
[4] Shri Himmatbhai Mohanbhai Kheni
[5] Shri Mukeshbhai Mavjibhai Patel
[6] Shri Kanjibhai Mavjibhai Patel &
[7] Shri Vipulkbhai Manjibhai Patel

It may be mentioned that all the above persons are the family members and relate to M. Kantilal family. Further, the Memorandum of Association shows that the main object of the company are as under :-

"To takeover business, and undertaking carried on under the name and style of M/s M Kantilal & Company, having its registered office at 1205, Panchratna, Opera House, Bombay – 400 004 alongwith all the belonging, funds, assets, rights, privileges, liabilities, obligations, and contracts of M/s M Kantilal & Company, and on such takeover the firm shall stand dissolved.

To carry on in India and elsewhere the business of manufacturing, dealing, buying, selling, importing and exporting of gems, diamonds (natural and synthetic), pearls, rubies, emeralds and precious and semi-precious stones of every kind and description, in rough, uncut, cut, or polished form, ornaments and jewelleries of gold, silver, platinum or any other precious metal and alloy thereof, including ornaments and jewelleries studded with precious or semi-precious stones.

To carry on the business of manufacturing trading, dealing, importing and exporting in and of, all forms of precious and semi-precious stones including Diamonds, Gems, Rubies, Sapphires, Emeralds, Pearls."

A perusal of the main object of Memorandum of Association revels that the company was formed with the main object to takeover the business of out going concern i.e. M/s M Kantilal & Co., a

firm where most of the Directors were the partners.

Thereafter, from the inception of the company, the objectives of M/s M Kantilal & Co Ltd was to run a family business of M Kantilal family.

Huge undisclosed income is computed U/s 158 BC in the name of M/s M Kantilal & Co, firm for the block period taking over of the firm by M/s M Kantilal & Co Ltd. The total undisclosed income was computed for Rs. 884354291/- and the said assessment has been set-aside by CIT(A) and the assessment is in progress.

Further, the Directors of the company have created huge assets in their own name in the form of immovable property. Therefore, it is evident that the unaccounted income of the company which is flagship concern of the Group has been utilised for acquiring the property in the hands of Directors. This view is further fortifies by analysing the balance-sheet of the Company which shows that there is not even a single immovable property in the name of the company.

Section 179 deals with recovery of demand from a Director in the case of private limited company when the demand cannot be recovered from the company. In the instant case, M/s M Kantilal & Co. Ltd. has not intentionally been registered with the words “private” in Incorporation Certificate, to escape the responsibility U/s 179. In the circumstance discussed above, it is clear that the Directors have enjoyed unaccounted income of the assessee. Therefore, it is proper to recover the dues of tax from the Directors. In this connection, the decision of the Supreme Court reported in 1996 All India Reporter 2005 in the case of DDA Vs Skipper Construction Co Pvt Ltd is directly applicable where the Hon'ble Supreme Court is of the view that if the members and directors of any company commits illegality and defrauding people by the formation of corporate body then the theory “Lifting the corporate veil” may be applied. Gist of the decision is as under :

"The Hon'ble Supreme Court of India reported in 1996 AIR 2005 in the case of DDA Vs Skipper Construction Co Pvt ltd has given verdict on the theory of "Lifting the corporate veil". The Hon'ble Supreme Court has held that in case of corporate bodies created by the individual and his family members for committing illegality and defrauding people, the Court can treat them one entity. The Hon'ble Supreme Court has further held that the concept of corporate entity was evolved to encourage and promote trade and commerce but not to commit illegalities or to defraud people. Where, therefore the corporate character is employed for the purpose of the committing illegality or for defrauding others, the Court could ignore the corporate character and will look at the reality behind the corporate veil so as to enable it to pass appropriate orders to do justice between the parties concerned. The fact that an individual and members of his family have created several corporate bodies would not prevent the Court from treating all of them as one entity belonging to and controlled by that individual and family if it is found that these corporate bodies are merely cloaks behind which lurks that individual and/or members of his family and that the devise of incorporation was really a ploy adopted for committing illegalities and/or to defraud people."

In the instant case M/s M Kantiulal & Co Ltd, the word "Pvt. Ltd" is not mentioned in incorporation certificate. The fact remains that all shareholders and directors belong to a single family and these family members have earned huge unaccounted income of Rs. 259 crores as assessed in the hands of company after taking into account the evidences gathered as a result of search & seizure operation. Evidence gathered during the search & seizure operation further fortifies the idea that this company has been used as a conduit for generating unaccounted wealth. Further, the assessee company has not offered to general public any share for subscription. All the shares are held by directors only."

2.5) The petitioner thereupon made a representation to the Assistant Commissioner on 6.5.2002. In such representation, he reiterated his contention that section 179 of the Act would not be applicable in case of a public company. He also tried to dislodge the Assistant Commissioner's findings with respect to share holdings of the petitioner and his family members as directors of the company and other grounds on which the Assistant Commissioner had ordered recovery from the petitioner. He strongly opposed the action of the Assistant Commissioner in applying the principle of lifting or piercing the corporate veil. He also tried to demonstrate through different figures that the investments made by the directors of the said company including himself were from their own sources. The petitioner thereafter, filed a revision application before the Commissioner against the order of the Assistant Commissioner dated 15.4.2002 in which he mainly contended that section 179 of the Act had no applicability.

2.6) The Commissioner by his order dated 9.4.2003 however, was pleased to reject the petitioner's revision application under section 264 of the Act. He concurred with the view of the Assistant Commissioner regarding requirement of lifting the veil. In this respect his conclusions were as under :

"(ii) In the order made u/s. 179 of the Act, the Assessing Officer has lifted the corporate veil in the case of M/s M Kantilal & Co. Ltd by relying on the decision of the Hon'ble Supreme Court in the case of Delhi Development Authorities Vs. Skipper Construction Co. Pvt.Ltd., AIR 1996 Supreme Court 2005. In the aforesaid case, the Hon'ble Supreme Court has held that the concept of corporate entity was evolved to encourage and promote trade and commerce but not to commit illegality or to defraud people. It had further held that the fact that an individual and members of his family have created several corporate bodies would not prevent the Court from treating all of them as one entity belonging to and controlled by that individual and family if it was found that these corporate bodies were merely cloaks behind which lurked that individual and/or members of his family and that the devise of incorporation was really a ploy adopted for committing illegalities and/or to defraud people. The Assessing Officer stated in the order u/s. 179 of the Income-tax Act made in the case of the assessee that the fact remained that all the directors, who were the only shareholders of M/s M Kantilal & Co. Ltd., belonged to the same family. The aforesaid company had been formed with the main object to take over the business of partnership firm known as M/s M Kantilal & Co., whose partners (four in member) became director of the company alongwith three other members of the family. These family members had earned huge unaccounted income which was evidenced on the basis of the material found during the course of the search & seizure operation. He further held that the aforesaid company was being used as a conduit for generating unaccounted wealth. This view was fortified by analysing the balance-sheet of the company which showed that there was not even a single immovable property in the name of the company. The Assessing Officer stated that the said company had not offered to the general public any shares for subscription and that all the shares of the company were held by its directors only. Thus, the management and control

over the affairs of the company were with the aforesaid seven persons who belonged to a family. He thus lifted the veil of public company and held that M/s M Kantilal & Co. Ltd was in essence, a private company. For the reasons given by the Assessing Officer in the order u/s 179 of the Act, I agree with the conclusion reached by him with regards to the real character of M/s M. Kantilal & Co. Ltd. In view of the above, the reliance placed by the assessee on the decision of the hon'ble Supreme Court in the case of M. Rajamoni Amma Vs. DCIT (1992) , 195 ITR, 873 is not in order as on facts it was established by the Assessing Officer that the apparent entity of M/s M. Kantilal & Co. Ltd as a public company was merely a sham and a cloak to facilitate avoidance of recovery of tax due from it.

(iii) The principle laid down by the hon'ble Supreme Court in its decision in the case of Delhi Development Authorities Vs. Skipper Construction Co. Pvt.Ltd. does not distinguish between a public company and a private company. As mentioned in the preceding paragraph, the hon'ble Supreme Court has held in the aforesaid case that where the corporate character was employed for the purpose of committing an illegality or for defrauding others, the court could ignore the corporate character and look at the reality behind the corporate veil. It is clear from the facts discussed by the Assessing Officer in the order made by him u/s. 179 of the Act that the purpose behind the assumed entity of a public company in the case of M/s M Kantilal & Co. Ltd was to facilitate avoidance of recovery of tax due from it. The aforesaid company has been formed with the main object to take over the business of partnership firm known as M/s M.Kantilal & Co. The search and seizure operation had revealed unaccounted production and unaccounted transactions during the period prior to the date of incorporation when the firm was in existence. The same pattern of unaccounted transactions continued after the formation of the company. Through the entity of M.s M.Kantilal & Co. Ltd., huge undisclosed income had been earned which was eventually brought to tax in the order

of block assessment made in its case. However, there was not even a single immovable property in the name of the company which could have been attached for recovery of its tax dues. The apparent status of a public company would have protected its directors from meeting its tax liability as their liability thereunder would have been limited. Thus, it is evident that the character of a public company was employed in the case of M/s M. Kantilal & Co. Ltd to commit an illegality as mentioned above. In view of the above, the contention of the assessee referred to at point (iii) of para 1 is rejected.

(iv) The contention of the assessee mentioned at point no. (iv) of para 1 is not in order. Under section 179 of the Act, there is no bar on the Assessing Officer to pass an order thereunder where a statement has been drawn by the T.R.O under section 222. It is only in respect of the modes of recovery specified in section 226 of the Act that after a certificate is drawn under section 222, T.R.O. Alone has the powers to make use of them. The mode of recovery of tax due from a private company specified in section 179 of the Act is distinct from the modes of recovery specified in section 226. Therefore, the aforesaid contention of the assessee is rejected.

(v) As for the contention of the assessee that the action to lift the corporate veil could be taken by a court and not by the Assessing Officer, the Hon'ble Supreme Court, in the case of C.I.T. Vs. Meenakshi Mills Ltd. & Others, (1967), 63 ITR, 609, has held that the income-tax authorities are entitled to pierce the veil of corporate entity and to look at the reality of the transaction to examine whether the corporate entity was being used for tax evasion. In the aforesaid case, a separate corporate entity was brought into existence with the ulterior motive of evading the tax obligations by the assessee. In the case of the assessee also, the entity of M/s M Kantilal & Co. Ltd was brought into existence as a public company with the motive of evading the tax obligations by him as also by the other directors of the company. In view of the

above, the contention of the assessee at point no. (1) of para 3 is rejected.

(vi) As for the contention of the assessee at point no. (ii) of para 3, it is seen that the Assessing Officer had mentioned the fact that the company, M/s.M Kantilal & Co. ltd, had not gone in for a public issue of its shares, along with many other facts,in the order u/s.179 of the Act to substantiate his conclusion that the aforesaid company was, in essence, a private company. I agree with the Assessing Officer that the totality of the facts in the case of M/s.M Kantilal & Co. ltd revealed that it was, in reality, a private company only.

(vii) As for the contention of the assessee at point no.(iii) of para.3, it is seen that the company M/s.M Kantilal & Co. ltd was assessed to tax on undisclosed income of Rs.259.23 crores for the block period. In the appellate order passed by the CIT(A) against the order of aforesaid assessment, he confirmed assessment of undisclosed income to the extent of Rs.130.55 crores. A perusal of the balance- sheet of the company as on 31.3.2000 and on 31.3.2001 shows that the company does not have worthwhile liquid assets of its own. As mentioned earlier, it also does not have any immovable property of its own. On the other hand, the assessee and the other directors of the company have acquired a large number of immovable properties in their own name. It is well known that apart from the stated purchase consideration 'on money' is paid for acquiring such assets. The management and control of the affairs of the company is with the assessee and six other directors who are the members of the same family. They are privy to the unaccounted transactions of the company and the destination of the income generated from such transaction. In view of the above, the contention of the assessee at point no.(iii) of para.3 is rejected."

2.7) The petitioner at this stage approached this Court by filing the present

petition.

3. Learned counsel Shri J.P. Shah for the petitioner vehemently contended that the authorities erred in applying the provisions of section 179 of the Act when admittedly the company was a public company. He further submitted that in any case the company should be treated to be a deemed public company in terms of section 43A of the Companies Act.

3.1) Counsel relied on the decision of the Apex Court in case of **M.Rajamoni Amma and another v. Deputy Commissioner of Income-tax(assessment) and others** reported in 195 ITR 873 in which it was held that where the liability of a company had arisen after the company had become deemed public company, the directors of such company would not be liable to be proceeded against any recovery of tax dues of company under section 179 of the Act.

3.2) Counsel submitted that the principle of lifting the corporate veil would be inapplicable in the present case. He further submitted that there was no material on record in any case to apply such a principle.

3.3) Counsel also contended that even otherwise the requirements of section 179 of the Act were not fulfilled. The Assistant Commissioner had not held that non recovery of

dues of the company could be attributed to any gross negligence, misfeasance or breach of duty on part of the petitioner.

3.4) Counsel relied on the decision of Division Bench of this Court in case of **Bhagwandas J. Patel v. Deputy Commissioner of Income-tax** reported in 238 ITR 127 wherein it was held that liability of the tax dues is primarily of that of the company. The director can be proceeded against only if the Revenue establishes that tax could not be recovered from the company.

4. On the other hand, learned counsel for Shri Mehta for the Revenue opposed the petition contending that Assistant Commissioner as well as the Commissioner had examined the facts on record and found that it was not possible to make any recovery of the tax from the company. After following necessary procedure, order under section 179 of the Act was passed. He contended that in view of the fraud perpetrated by the petitioner and other directors of the company, it was a fit case where the corporate veil was required to be lifted. In support of his contentions, counsel relied on the following decisions :

1) In case of **U.K. Mehra v. Union of India and others** reported in 88 Company Cases 213, wherein Division Bench of Delhi High Court had invoked the principal of lifting or piercing the

corporate veil.

2) In case of **State of U.P. and others v. Renusagar Power Co. and others** reported in AIR 1988 Supreme Court 1737, wherein the Apex Court invoked such principle.

3) In case of **Tata Engineering and Locomotive Co. Ltd. v. The State of Bihar and others** reported in AIR 1965 Supreme Court 40, wherein the Apex Court had the occasion to discuss similar issue.

4) In case of **Life Insurance Corporation of India v. Escorts Ltd. and others** reported in AIR 1986 Supreme Court 1370.

5. Having thus heard learned counsel for the parties and having perused the documents on record, we may first deal with the contention of the petitioner regarding non recovery of the tax dues from the company and that such non recovery being not attributable to any negligence, misfeasance or breach of duty on part of the petitioner.

6. Section 179 as is well known permits recovery of the tax due of a private company from its directors under certain circumstances. Section 179 which is of paramount importance for us 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."

7. Sub-section(1) of section 179 as can be noticed provides that notwithstanding anything contained in the Companies Act, 1956, where any tax due from a private company or other company during the period when such company was a private company cannot be recovered, then, every person who was a director of the said company at the relevant time shall be jointly and severally liable for the payment of such tax. Such recovery however can be avoided, if such a person proves that 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.

8. Fundamental requirement for applicability of section 179 of the Act, of-course is that tax dues cannot be recovered from the company. In case of **Bhagwandas J. Patel** (supra), Division Bench of this Court had taken a similar view. Division Bench observed as under :

"A bare perusal of the provision shows that before recovery in respect of dues from the private company can be initiated against director, to make them jointly and severally liable for such dues, it is necessary for the revenue to establish that such recovery cannot be made against the company and then and then alone it can reach the directors who were responsible for the conduct of business during the previous year in relation to which liability exists."

In case of **Indubhai T. Vasa(HUF) v. Income-tax Officer** reported in (2006) 282 ITR 120(Guj.), this Court reiterated such proposition following the decision in case of **Bhagwandas J. Patel**(supra) observing :

"In these circumstances, it is not possible to accept the stand of the respondent that despite best efforts the taxes due from the Company cannot be recovered. As laid down by this Court the phrase "cannot be recovered" requires the Revenue to establish that such recovery cannot be made against the Company and then and then alone would it be permissible for the Revenue to initiate action against the director or directors responsible for conducting the affairs of the Company during the relevant accounting period. Hence, the prerequisite condition stipulated by Section 179 of the Act remains unfulfilled in context of the

facts available on record by virtue of the impugned order as well as the affidavit-in-reply."

9. In this respect we may notice the efforts made by the recovery officer to recover such dues from the company. In his impugned order dated 15.4.2002, he has outlined as many as 35 steps taken to recover the dues which read as under :

Sr. No.	Date	Recovery measures undertaken	Outcome of the measures
1	30.03.01	Applied to CIT., Surat for cash adjustment	Rs.3,75,000 is adjusted
2	31.03.01	Adjustment of refund of A.Y 1998-99	Rs.15.49 lacs is adjusted
3	31.03.01	Adjustment of refund of A.Y 2000-01	Rs.33,240/- is adjusted
4	26.06.01	Attachment notice u/s.226(3) of the Act issued to the State Bank of Saurashtra, Surat.	The bank informed on 2.7.99 that there is no remaining positive balance on 30.3.01
5	27.06.01	Notice issued before resorting to coercive actions	No reply received; Coercive actions started as per law.
6	27.06.01	Notice u/s221(1) of the Act issued for imposing penalty	Co reply received; However, penalty was not imposed as this will further add in the existing very high demand
7	30.06.01	Attachment notice 226(3) of the Act issued to the State Bank of Saurashtra, Fort, Mumbai	The Bank sent DD of Rs.1600/- on 6.7.99 as remaining balance on the date of attachment
8	30.06.01	Attachment notice 226(3) of the Act issued to the State Bank of Saurashtra, Overseas Br.,, Mumbai	The Bank sent DD of Rs.50,000/- on 10.7.99 as remaining balance on the day of attachment

9	12.09.01	Attachment notice 226(3) of the Act issued to the four addl. Banks at Mumbai and Surat where assessees' accounts were suspected	The banks replied on 19 & 25.0.01 that they do not maintain any such accounts of the assessee
10	17.09.01	Intimation is sent to the TRO. For issue of certificate u/s222 & 223 of the Act and for attachment of property	
11	18.09.01	Attachment notice u/s 228(3) of the Act is sent to two debtors as reflected in the balance sheet filed for 31.3.00	
12	18.09.01	Show cause notice u/s 179 of the Act is issued to seven directors of the assessee co.	
13	29.10.11	The assessee's return of income and Balance Sheet as on 31.3.01 was filed and it was closely scrutinized.	
14	02.11.01	Director of the assessee co. is called and he is directed to submit list of current assets, deposits & debtors	
15	06.11.01	The TRO issued notice of attachment in ITCP-3 for attachment of four current debtros as under :- -Golden Soft Link Ltd. Mumbai -Sh Annasaheb M. patel, A'nagar Rs. 9.00 lacs -Smt. Sushila M. Patil, A'nagar Rs. 1.00 lac -Smt Chandanben M Shah, Mumbai	Address given was old new address has been traced out These two persons have confirmed the due. Necessary further proceedings are being taken to recover the amt. No amt. is outstanding as per replied filed by the assessee.

16	06.11.01	Further notice u/s 226(3) was issued to one concern at Mumbai who has purchased polished diamond from assessee in Sept.01 M/s. Rough Stone	M/s Rough Stone, has replied that payment has already been made through Andhra Bank to the assessee. The assessee has not given the details of the said bank. After correspondence with the banker of Rough Stone the address of Andhra bank has been traced and the account where such amount has been deposited & appropriated would be analyzed after obtaining the said account where money is credited.
17	06.11.01	Another notice u/s.226(3) was issued to the Oriental Insurance Co. ltd at Mumbai where the assessee had lodged a claim of Rs.1.85 crores on 21.11.97 for theft of deamnd.	Insurance co. has replied that there is not claim as decided by Insurance co. This decision was communicated to the assessee co. Proceedings for giving false information would be initiated.
18	09.11.01	Show cause notice u/s281 was issued to the assessee for treating the sale of car & laser machine as void	No reply received from the assessee. TRO has addressed a letter to RTO for treating the sale as void and to deregister the vehicles in company's name
19	09.11.01	M/s Rough Stones, Mumbai a current debtors amounting to Rs. 23.00 lacs attached on 9.11.01	M/s. Rough Stone replied on 9.11.01 & 25.12.01 that payment was made on 3.11.01 by bankers' cheque of Bharat Overseas Bank, Mumbai
20	04.12.01	Letter issued to Bharat Overseas Bank, Mumbai calling for details of transactions of Rs.23.00 lacs.	Reply received on 18.1.02 & 11.2.01 giving details & address of Andhra bank, Mumbai where the defaulter has account

21	27.12.01	A show cause notice for treating sale of Motorcar as void & cancelled u/s281 is issued.	No reply received till date
22	01.01.01	Letter issued to RTO, Surat for cancellation of Registration of six car sold by M/s. M Kantilal & Co Ltd., Mumbai in Aug., 2001	The RTO, Surat vide its ltr dtd 7.1.02 replied that all the vehicles are sold and transferred to different persons
23	03.01.02	Movable assets at Surat attached. Letter issued to the defaulter company for not to tamper with the said assets	Attachment done.
24	18.01.02	Issued summons to three Directors of the defaulter company, they are (i) Sh. Kanjibhai M. Patel (ii)Sh. Himmatbhai M. Kheni (iii)Sh. Kantilal M. Kheni	Attended on 21.1.02 & statemnt on oath about movable immovable property recorded Not served since he was out of India. Not served as he was out of station.
25	-do-	Letter issued to the Directors of M kantilal & co. (Manjibhai Mavjibhai Patel(Kheni) to pay the outstanding demand within seven days.	No reply till date received.
26	23.01.01	A letter issued to Andhra bank, Mumbai by RPAD calling for bank account details and staetment of M/s M Kanitlal & co. ltd., Mumbai.	The Andhra Bank replied vide its letter dated 4.2.02(received on 7.2.02) that no such account exists in its office.
27	-do-	Letter for attachment of drugs and polished diamond and calling for valuation report for the said diamond issued	Reply received on 25.1.02. The defaulter company has requested for one week time for valuation report
28	23.01.02	The defaulter company was asked to confirm the ownership of offices No. 1204/A and 1407/B of Panchratna building, Opera house, Mumbai on telephone	Reply received on 25.1.02 that the 1205/A premises is in the name of director Shri Manjibhai Mavjibhai Patel and 1407/B is on rent.The same fact is confirmed by the TRO-16(3), Mumbai.

29	-do-	Notice u/s 226(3) was issued to the State bank of Saurashtra, Dena Bank, Varachha road and Dena Bank Galemandi Br. Surat	SBS-2 A/c. Current attached. SBS-3 A/c. No. Current/savings account Dena Bank, V.road, No. A/c. Dena Bank, Galemandi-No.A/c.
30	30.01.02	A letter issued to M/s. M Kantilal & co. ltd for valuation of diamond stocks.	Not replied
31	-do-	A notice u/s 226(3) issued by RPAD to two current depositors of M/s. M Kantilal & co. for remitting the amount of Rs.10.00 lacs to the undersigned	-do-
32	31.01.02	Another letter is also issued along with the above notices to both the current depositors directing them to submit a copy of books of account of ledger account to the undersigned	-do-
33	-do-	Another notice u/s 226(3) of the IT Act, 1961 sent by RPAD to the Andhra bank, fort, Mumbai with a view to attach and collect the balance amount lying in the account of defaulter company	Replied vide its letter dated 5.3.02 (received on 8.3.02) that no such account exist in the branch
34	25.02.02	A cheque of Rs.85,000/- received from the defaulter company against the sale of old generator set.	Deposited in the bank and it was cleared on 27.2.02
35	27.02.02	A letter is issued to the defaulter company for making an arrangement of presence of owner of the premises for attachment of the immovable property lying at Mumbai.	No reply received till date.

10. It is not in dispute that despite such efforts no recovery could be made. It can thus be straightway seen that despite several attempts made by the respondents, no recovery could be made from the company. Counsel for the petitioner therefore, would be wholly incorrect in suggesting that revenue did not establish that tax could not be recovered from the company.

11.With respect to the finding that such recovery cannot be attributed to any gross negligence, misfeasance or breach of duty on part of the petitioner also we are afraid such a contention cannot be accepted. This is so because in our view such condition is expressed in the negative terms namely, that unless the Director proves that non recovery cannot be attributed to any of the above-noted causes. In other words, once it is established that tax dues could not be recovered from the company and that a certain person was a director of the said private company at the relevant time, his joint and several liability would arise. It would be upto him then to establish that such liability should not arise since the non recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to affairs of the company. In the present case, the petitioner never putforth any such defence, did not urge any grounds or bring any material before the respondents to contend that his case should fall within exclusion clause of sub-section(1) of section 179. The contention that onus was on the Revenue to establish that such non recovery was attributable to gross negligence, misfeasance or breach of duty on his part, is not borne out from the plain language used in sub-section(1) of section 179 of the Act. In a recent decision dated 25,26/09/2012 passed in Special Civil Application No.3910/2012 and allied matters in case of **Maganbhai Hansrajbhai Patel v. Asst.**

Commissioner of Income Tax and others, Division Bench of this Court had observed as under :

"21. To our mind, the authority completely failed to appreciate in proper perspective the requirement of section 179(1) of the Act. We may recall that said provision provides for a vicarious liability of the director of a public company for payment of tax dues which cannot be recovered from the company. However, such liability could be avoided if the director proves that the non recovery cannot be attributed to any gross negligence, misfeasance or breach of duty on his part in relation to the affairs of the company. It is of-course true that the responsibility of establishing such facts is cast upon the director. Therefore, once it is shown that there is a private company whose tax dues have remained outstanding and same cannot be recovered, any person who was a director of such a company at the relevant time would be liable to pay such dues. However, such liability can be avoided if he proves that the non recovery cannot be attributed to the three factors mentioned above. Thus the responsibility to establish such facts are on the director."

12. This brings us to the central and most hotly contested issue of piercing corporate veil. The fact that the company is a public company is not in dispute. The Revenue authorities while applying principle of lifting corporate veil have principally pressed in service the following factors which emerge from the impugned order of the Assistant Commissioner dated 15.4.2002. Such factors are :

i) Even after the attachment of the said stock of diamonds of the company, huge demand in excess of Rs.150 crores of tax dues had remained unpaid.

The balance sheet of the company shows that such undisclosed income had not been reflected in the accounted balance sheet of the assessee company. There is no immovable property in name of the company where such unaccounted income might have been invested. Thus apparently unaccounted income of the company has been misappropriated by the Directors and shareholders of the company.

ii) Memorandum of Understanding of the company shows that there are following directors/shareholders :

(1) Shri Manjibhai Mavjibhai Patel
(2) Shri Pravinbhai Mohanbhai Kheni
(3) Shri Kantibhai Mohanbhai Kheni
(4) Shri Himmatbhai Mohanbhai Kheni
(5) Shri Mukeshbhai Mavjibhai Patel
(6) Shri Kanjibhai Mavjibhai Patel
(7) Shri Vipulbhai Manjibhai Patel

All the above persons are family members and related to M Kantilal family.

iii) The memorandum of understanding shows that main object of the company was to takeover business, and undertaking carried on under the name and style of M/s. M. Kantilal & Company, along with all the belonging, funds, assets, rights, privileges, etc. To carry on in India and elsewhere the business of manufacturing, dealing, buying, selling, importing and exporting of gems, diamonds, pearls, rubies, etc. Thus the

company was formed with the main object of taking over the business of the outgoing concern i.e. M/s. M Kantilal & Co. where most of the Directors were partners.

iv) From the inception the company was to run as a family business of M. Kantilal and family.

v) Huge undisclosed income was computed under section 158BC of the Act in the name of the firm for the block period during which takeover of the firm of M/s. Kantilal & Co. Ltd. had taken place.

vi) Directors of the company had created huge assets in their own name in the form of immovable properties. It was therefore, evident that unaccounted income of the company was utilised for acquiring such properties by the directors.

vii) The Assistant Commissioner therefore, concluded that the evidence shows that the company was used as a conduit for generating unaccounted wealth. Shares of the company were not offered to general public for subscription. All shares were held by the directors only.

13. Question is if these facts are established should the corporate veil be lifted?

14.The principle of lifting or piercing the corporate veil is neither new nor unknown. It is however, not possible of any precise definition or application in a straitjacket formula. We may notice some of the authorities dealing with such a concept.

1) In case of **State Trading Corporation of India Ltd. v. The Commercial Tax Officer and others** reported in AIR 1963 Supreme Court 1811, nine Judge Bench of the Supreme Court considered the question whether a company can be considered a citizen and be permitted to approach Supreme Court under Article 32 of the Constitution of India for asserting its fundamental right under Article 19(1) of the Constitution. By majority judgement it was held that company being a juristic person is different from a citizen. Hidayatullah, J in his concurring but separate judgement made following observations on the question of effect of incorporation of a company:

"29. We are dealing here with an incorporated company. The nature of the personality of an incorporated company which arises from a fiction of law, must be clearly under stood before we proceed to determine whether the word 'citizen' used in the Constitution generally or in Article 19 specially, covers an incorporated company. Unlike an unincorporated company, which has no separate existence and which the law does not distinguish from its members an incorporated company has a separate existence and the law recognises it as a legal person separate and distinct from its members. This new legal personality emerges from the moment of incorporation and from that date the persons subscribing to the memorandum of association and

other persons Joining as members are regarded as a body corporate or a corporation aggregate and the new person begins to function as an entity. But the members who form the incorporated company do not pool their status or their personality. If all of them are citizens of India the company does not become a citizen of India any more than if all are married the company would be a married person. The personality of the members has little to do with the persona of the incorporated company. The persona that comes into being is not the aggregate of the personae either in law or in metaphor. The corporation really has no physical existence ; it is a mere 'abstraction of law' as Lord Selborne described it in G. E. Rly. Co. v. Turner(1872) 8 Ch A 149 at p.152 or as Lord Macnaghten said in the well-known case of Salomon v. Salomon & Co.ltd. 1897 AC 22 at page .51. it is "at law a different person altogether from the subscribers to the memorandum of association." This distinction is brought home if one remembers that a company cannot commit crimes like perjury, bigamy or capital murder'. This persona dicta being a creature of a fiction, is protected by natural limitations as pointed out by Palmer in his Company Law (20th edn.) p. 130 and which were tersely summed up by counsel in R. v. City of London, (1632) 8 SV Tr. 1087 at p.1138 when he asked "Can you hang its common seal?". It is true that sometimes the law permits the corporate veil to be lifted, but of that later."

In the later portion of the judgement, learned Judge dealt with the question of lifting of corporate veil in that case, for benefit of the company and observed as under :

"65. The next question is whether the State Trading Corporation is a department or organ of Government notwithstanding the formality of incorporation. On behalf of the Corporation it is contended that if the corporate veil is pierced one sees that the right to invoke Art. 19(1)(f) and (g) is being claimed by three persons who are admittedly citizens of India namely the President

of India and the two secretaries. The contention on the other side is that the corporate veil cannot be pierced at all and that if it is, then behind that veil there is the Government of India.

68. In my judgment it is not possible to pierce the veil of incorporation in our country to determine the citizenship of the members and then to give the corporation the benefit of Art. 19. If we did pierce the veil and saw that the corporation was identical with Government there would be difficulty in giving, relief unless we held that the State can be its own citizen. Nor is it possible to raise an irrebuttable presumption about the citizenship of the members. I have given detailed reasons already in answer to the first question posed for our decision. If we go by the corporate entity then we must hold that Art. 19 applies to natural persons. On that subject I have said a great deal but what I have said sums up to the following passage from Ducat v. Chicago, (1868) 48 Ill 172 quoted by Farnsworth (op. cit.) at p. 310 and approved by the United States Supreme Court :- "The term citizen can be correctly understood in no other sense than that in which it was understood in common acceptation when the Constitution was adopted, and as it is universally explained by writers on government, without exception. A citizen is of the genus homo, inhabiting, and having certain rights in some State or district..... these privileges attach to him in every State into which he may enter, as to a human being-as a person with faculties to appreciate them, and enjoy them, and not to an intangibility, a mere legal entity, an invisible artificial being, but to a man, made in God's image."

2) In case of **Tata Engineering and Locomotive Co. Ltd.**(supra), five Bench judgement of the Supreme Court once again held that the Corporations and Companies not being the citizens cannot file petition under Article 32 of the Constitution. In that context, the Court also

examined whether by lifting the corporate veil, such petition can be entertained. In this context, it was observed that :

"24. The true legal position in regard to the character of a corporation or a company which owes its incorporation to a statutory authority, is not in doubt or dispute. The corporation in law is equal to a natural person and has a legal entity of its own. The entity of the corporation is entirely separate from that of its shareholders; it bears its own name and has a seal of its own; its assets are separate and distinct from those of its members; it can sue and be sued exclusively for its own purpose; its creditors cannot obtain satisfaction from the assets of its members; the liability of the members or shareholders is limited to the capital invested by them; similarly, the creditors of the members have no right to the assets of the corporation. This position has been well-established ever since the decision in the case of Salomon v. Salomon & Co, 1897 AC 22 was pronounced in 1897; and indeed, it has always been the well- recognised principle of common law. However, in the course of time, the doctrine that the corporation or a company has a legal and separate entity of its own has been subjected to certain exceptions by the application of the fiction that the veil of the corporation can be lifted and its face examined in substance. The doctrine of the lifting of the veil thus marks a change in the attitude that law had originally adopted towards the concept of the separate entity or personality of the corporation. As a result of the impact of the complexity of economic factors, juidical decisions have sometimes recognised exceptions to the rule about the juristic personality of the corporation. It may be that in course of time these exceptions may grow in number and to meet the requirements of different economic problems, the theory about the personality of the corporation may be confined more and more.

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26. It is unnecessary to refer to the facts in

these two cases and the principles enunciated by them, because it is not disputed by the respondents that some exceptions have been recognised to the rule that a corporation or a company has a juristic or legal separate entity. The doctrine of the lifting of the veil has been applied in the words of Palmer in five categories of cases : where companies are in the relationship of holding and subsidiary (or sub-subsidiary) companies; where a shareholder has lost the privilege of limited liability and has become directly liable to certain creditors of the company on the ground that, with his knowledge, the company continued to carry on business six months after the number of its members was reduced below the legal minimum; in certain matters pertaining to the law of taxes, death duties and stamps, particularly where the question of the "controlling interest" is in issue; in the law relating to exchange control; and in the law relating to trading with the enemy where the test of control is adopted(1). In some of these cases, judicial decisions have no doubt lifted the veil and considered the substance of the matter.

27. Gower has similarly summarised this position with the observation that in a number of important respects, the legislature has rent the veil woven by the Salomon case, 1897 AC 22. Particularly is this so, 'says Gower, in the sphere of taxation and in the steps which have been taken towards the recognition of enterprise-entity rather than corporate- entity. It is significant, however, that according to Gower, the courts have only construed statutes as "cracking open the corporate shell" when compelled to do so by the clear words of the statute; indeed they have gone' out of their way to avoid this construction whenever possible. Thus, at present, the judicial approach in cracking open the corporate shell is somewhat cautious and circumspect. It is only where the legislative provision justifies the adoption of such a course that the veil has been lifted. In exceptional cases where courts have felt "themselves able to ignore the corporate entity and to treat the individual shareholders as

liable for its acts",(2) the same course has been adopted. Summarising his conclusions, Gower has classified seven categories of cases where the veil of a corporate body has been lifted. But it would not be possible to evolve a rational, consistent and inflexible principle which can be invoked in determining the question as to whether the veil of the corporation should be lifted or not. Broadly stated, where fraud is intended to be prevented, or trading with an enemy is sought to be defeated, the veil of a corporation is lifted by judicial decisions and the shareholders are held to be the persons who actually work for the corporation."

3) In case of **the Commissioner of Income tax, Madras v. Sri Meenakshi Mills Ltd., Madurai** reported in AIR 1967 Supreme Court 819, the Apex Court was considering a situation where it was found that entire transaction of lending and borrowing of money and bringing it into British India from non taxable territory formed part of basic arrangement between Bank and assessee companies. It was so done that money was brought to British India after it was taken by the assessee company outside the taxable territory. It was in this context the Apex Court observed that "it is well established that in a matter of this description the Income- tax authorities are entitled to pierce the veil of corporate entity and to look at the reality of the transaction. It is true that from the juristic point of view the company is a legal personality entirely distinct from its members and the company is capable of enjoying rights and being subjected to duties which are not the same as those enjoyed or borne

by its members. But in certain exceptional cases the Court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal facade. For example, the Court has power to disregard the corporate entity if it is used for tax evasion or to circumvent tax obligation."

4) In case of **Juggilal Kamlapat v. Commissioner of Income Tax, U.P.** reported in AIR 1969 Supreme Court 932, once again the Apex Court applied the principle of lifting of corporate veil in the context of taxing statute. It was a case where the Tribunal had found that transaction of termination of the managing agency was a colourable transaction and the real purpose was to hand over a sum of Rs. 2 lacs to the assessee firm. It was held that the payment was collusive and the partners of the firm continued to run and enjoy the benefit of managing agency as shareholders and Directors of the newly formed company by reason of their holding a majority of shares in that company. The Tribunal further held that the reason for terminating the managing agency was not a true reason but was merely a fake one and the whole transaction was a hoax for the purpose of evading income-tax. In other words, it was a collusive device practised by the managing company and the assessee firm for the purpose of evading income-tax both in the hands of the payer and of the payee. In this context

the Apex Court applied the principle of lifting the corporate veil making following observations :

"...In a matter of this description it is well-established that the Income-tax authorities are entitled to pierce the veil of corporate entity and look at the reality of the transaction. It is true that from juristic point of view the company is a legal personality entirely distinct from its members and the company is capable of enjoying rights and being subjected to duties which are not the same as those enjoyed or borne by its members. But in certain exceptional cases the Court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal facade. For example, the Court has power to disregard the corporate entity if it is used for tax evasion or to circumvent tax obligation or to perpetrate fraud. For instance, in Apthorpe v. Peter Schoenhofen Brewing Co. (1901) 4 Tax Cas 41, the Income Tax Commissioners had found as a fact that all the property of the New York company, except its land, had been transferred to an English company, and that the New York company had only been kept in being to hold the land, since aliens were not allowed to do so under New York law. All but three of the New York company's shares were held by the English company, and as the Commissioners also found, if the business was technically that of the New York company, the latter was merely the agent of the English company. In the light of these findings the Court of Appeal, despite the argument based on Salomon's ([1897] A.C. 22) case held that the New York business was that of the English company which was liable for English income tax accordingly. In another case Firestone Tyre and Rubber Co. v. Llewellin ([1957] 1 W.L.R. 464) an American company had an arrangement with its distributors on the Continent of Europe whereby they obtained supplies from the English manufacturers, its wholly owned subsidiary. The English company credited the American company with the price received after deducting the costs plus 5 per cent. It was conceded that the

subsidiary was a separate legal entity and not a mere emanation of the American parent, and that it was selling its own goods as principal and not its parent's goods as agent. Nevertheless, these sales were a means whereby the American company carried on its European business, and it was held by the House of Lords that the substance of the arrangement was that the American company traded in England through the agency of its subsidiary. It was accordingly held that the trade of selling tyres to persons outside the United Kingdom was carried on within the United Kingdom and was exercised by the American company through the English Co. as its agent. Therefore, the tax was chargeable in respect of that trade under Schedule D, para l(a)(iii), to the Income Tax Act, 1918, and the English Co. was the regular agent of the American Co. in whose name it was properly assessed to tax on profits of that trade under rules 5 and 10 of the All Schedules Rules. In our opinion the principle applies to the present case, and the Court is entitled to lift the mask of corporate entity if the conception is used for tax evasion or to circumvent tax obligation, or to perpetrate fraud. We accordingly reject the argument of Mr. Sukumar Mitra on this aspect of the case."

5) In case of **Life Insurance Corporation of India**(supra) in five Bench judgement of the Supreme Court, the Apex Court observed as under :

"90. It was submitted that the thirteen Caparo Companies were thirteen companies in name only; they were but one and that one was an individual, Mr. Swraj Paul. One had only to pierce the corporate veil to discover Mr. Swraj Paul lurking behind. It was submitted that thirteen applications were made on behalf of thirteen companies in order to circumvent the scheme which prescribed a ceiling of one per cent on behalf of each non-resident of Indian nationality or origin of each company 60 per cent of whose shares were owned by non-residents of Indian nationality/origin. Our attention was drawn to the picturesque pronouncement of Lord Denning

M.R. in Wallersteiner v. Moir 1974 3 All E.R. 217, and the decisions of this court in Tata Engineering and Locomotive Company Ltd. v. State of Bihar (1964) 6 S.C.R. 885 : (AIR 1965 SC 40), the Commissioner of Income Tax v. Meenakshi Mills AIR 1967 SC 819 and Workmen v. Associated Rubber Ltd. 1985 2 Scale 321. While it is firmly established ever since Salomon v. A. Saloman & Co. Limited 1897 A.C. 22, was decided that a company has an independent and legal personality distinct from the individuals who are its members, it has since been held that the corporate veil may be lifted, the corporate personality may be ignored and the individual members recognised for who they are in certain exceptional circumstances. Pennington in his Company Law (Fourth Edition) states :

"Four inroads have been made by the law on the principle of the separate legal personality of companies. By far the most extensive of these has been made by legislation imposing taxation. The Government, naturally enough, does not willingly suffer schemes for the avoidance of taxation which depend for their success on the employment of the principle of separate legal personality, and in fact legislation has gone so far that in certain circumstances taxation can be heavier if companies are employed by the tax-payer in an attempt to minimise his tax liability than if he uses other means to give effect to his wishes. Taxation of Companies is a complex subject, and is outside the scope of this book. The reader who wishes to pursue the subject is referred to the many standard text books on Corporation Tax, Income Tax, Capital Gains Tax and Capital Transfer Tax.

"The other inroads on the principle of separate corporate personality have been made by two section of the Companies Act, 1948, by judicial disregard of the principle where the protection of public interests is of paramount importance, or where the company has been formed to evade obligations imposed by the law, and by the courts implying in certain cases that a company is an agent or trustee for its members."

In Palmer's Company Law (Twenty-third Edition), the present position in England is stated and the occasions when the corporate veil may be lifted have been enumerated and classified into fourteen categories. Similarly in Gower's Company Law (Fourth Edition), a chapter is devoted to 'lifting the veil' and the various occasions when that may be done are discussed. In Tata Engineering and Locomotives Co. Ltd. (supra), the company wanted the corporate veil to be lifted so as to sustain the maintainability of the petition, filed by the company under Art. 32 of the Constitution, by treating it as one filed by the shareholders of the company. The request of the company was turned down on the ground that it was not possible to treat the company as a citizen for the purposes of Art. 19. In Commissioner of Income Tax v. Meenakshi Mills (supra), the corporate veil was lifted and evasion of income tax prevented by paying regard to the economic realities behind the legal facade. In Workmen v. Association Rubber Industry (supra), resort was had to the principle of lifting the veil to prevent devices to avoid welfare legislation. It was emphasised that regard must be had to substance and not the form of a transaction. Generally and broadly speaking, we may say that the corporate veil may be lifted where a statute itself contemplates lifting the veil, or fraud or improper conduct is intended to be prevented, or a taxing statute or a beneficent statute is sought to be evaded or where associated companies are inextricably connected as to be, in reality, part of one concern. It is neither necessary nor desirable to enumerate the classes of cases where lifting the veil is permissible, since that must necessarily depend on the relevant statutory or other provisions, the object sought to be achieved, the impugned conduct, the involvement of the element of the public interest, the effect on parties who may be affected etc."

6) In case of **Delhi Development Authority v.**

Skipper Construction Company (P) ltd. and another reported in AIR 1996 Supreme Court 2005, the Apex Court applied this concept making following observations :

"28. The concept of corporate entity was evolved to encourage and promote trade and commerce : but not to commit illegalities or to defraud people. Where, therefore, the corporate character is employed for the purpose of committing illegality or for defrauding others, the court would ignore the corporate character and will look at the reality behind the corporate veil so as to enable it to pass appropriate orders to do justice between the parties concerned. The fact that Tejwant Singh and members of his family have created several corporate bodies does not prevent this Court from treating all of them as one entity belonging to and controlled by Tejwant Singh and family if it is found that these corporate bodies are merely cloaks behind which lurks Tejwant Singh and/or members of his family and that the device of incorporation was really a Ploy adopted for committing illegalities and/or to defraud people."

7) In case of the **Workmen Employed in Associated Rubber Industry Ltd., Bhavnagar v. The Associated Rubber Industry Ltd., Bhavnagar and another** reported in AIR 1986 Supreme Court 1, the Apex Court referred to and relied upon the decision of **Sri Meenakshi Mills Ltd., Madurai**(supra) and observed as under :

"4. It is true that in law The Associated Rubber Industry Ltd. and Aril Holdings Ltd. were distinct legal entities having separate existence. But, in our view, that was not an end of the matter. It is the duty of the court, in every case where ingenuity is expended to avoid taxing and welfare legislations, to get behind

the smoke-screen and discover the true state of affairs. The court is not to be satisfied with form and leave well alone the substance of a transaction. In the Commr. of Income-Tax, Madras v. Sri Meenakshi Mills Ltd. (1967) 1 SCR 934 at 941:(AIR 1967 SC 819 at Pp.822-23), the judicial approach to such problems was stated as follows :

"It is true that from the juristic point of view the company is a legal personality entirely distinct from its members and the company is capable of enjoying rights and being subjected to duties which are not the same as those enjoyed or borne by its members. But in certain exceptional cases the Court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal facade. For example, the Court has power to disregard the corporate entity if it is used for tax evasion or to circumvent tax obligation. For instance, in Apthorpe v. Peter Schoenhofen Brewing Co. (1899) 4 Tax Cas 41, the Income tax Commissioners had found as a fact that all the property of the New York company, except its land, had been transferred to an English company, and that the New York company had only been kept in being to hold the land, since aliens were not allowed to do so under New York law. All but three of the New York Company's shares were held by the English company, and as the Commissioner also found, if the business was technically that of the New York company, the latter was merely the agent of the English company. In the light of these findings the Court of Appeal, despite the argument based on Salomon's case. (1897) A.C. 22 held that the New York business was that of the English company which was liable for English income tax accordingly. In another case-Fire stone Tyre and Rubber Co. v. Llewellin (1957) 1 W.L.R. 464- an American company had an arrangement with its distributors on the Continent of Europe whereby they obtained supplies from the English manufacturers, its wholly owned subsidiary. The English company credited the American with the price received after deducting the costs plus 5 per cent. It was conceded that the subsidiary was a separate legal entity and not a mere emanation of the American

parent, and that it was selling its own goods as principal and not its parent's goods as agent. Nevertheless, these sales were a means whereby the American company carried on its European business, and it was held that the substance of the arrangement was that the American company traded in England through the agency of its subsidiary. We therefore, reject the argument of Mr. Venkataraman on this aspect of the case. More recently we have pointed out in Mc Dowell and Company Limited v. Commercial Tax Officer (1985) 3 SCC 230.

"It is up to the Court to take stock to determine the nature of the new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices could be related to the existing legislation with the aid of 'emerging techniques of interpretation as was done in Ramsay((1981) 1 ALL ER 865), Burmah Oil (1982 STC 30) and Dawson(1984-1 ALL ER 530), to expose the devises for what they really are and to refuse to give judicial benediction."

In that case, the court also had occasion to refer to the following observations of Lord Brightman in Furniss v. Dawson (1984) 1 All ER 530 :

"The fact that the court accepted that each step in a transaction was a genuine step producing its intended legal result did not confine the court to considering each step in isolation for the purpose of of assessing the fiscal results."

Avoidance of welfare legislation is as common as avoidance of taxation and the approach in considering problems arising out of such avoidance has necessarily to be the same."

8) In case of **Renusagar Power Co. and others**(supra), the Apex Court observed as under :

"63. It is hightime to reiterate that in the expanding of horizon of modern jurisprudence, lifting of corporate veil is permissible. Its frontiers are unlimited. It must, however, depend primarily on the realities of the situation. The

aim of the legislation is to do justice to all the parties. The horizon of the doctrine of lifting of corporate veil is expanding. Here, indubitably, we are of the opinion that it is correct that Renusagar was brought into existence by Hindalco in order to fulfill the condition of industrial licence of Hindalco through production of aluminium. It is also manifest from the facts that the model of the setting up of power station through the agency of Renusagar was adopted by Hindalco to avoid complications in case of take over of the power station by the State or the Electricity Board. As the facts make it abundantly clear that all the steps for establishing and expanding the power station were taken by Hindalco, Renusagar is wholly-owned subsidiary of Hindalco and is completely controlled by Hindalco. Even the day-to-day affairs of Renusagar are controlled by Hindalco. Renusagar has at no point of time indicated any independent volition. Whenever felt necessary, the State or the Board have themselves lifted the corporate veil and have treated Renusagar and Hindalco as one concern and the generation in Renusagar as the own source of generation of Hindalco. In the impugned order of the profits of Renusagar have been treated as the profits of Hindalco.

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65. The veil on corporate personality even though not lifted sometimes, is becoming more and more transparent in modern company jurisprudence. The ghost of Salomon's case (1897 AC 22)still visits frequently the hounds of Company Law but the veil has been pierced in many cases. Some of these have been noted by Justice P.B. Mukharji in the New Jurisprudence. (Tagore Law Lecture 183).

66. It appears to us, however, that as mentioned the concept of lifting the corporate veil is a changing concept and is of expanding horizons. We think that the appellant was in error in not treating Renusagar's power plant as the power plant of Hindalco and not treating it as the own source of energy. The respondent is liable to duty on the same and on that footing alone; this

is evident in view of the principles enunciated and the doctrine now established by way of decision of this Court in Life Insurance Corpn of India, (AIR 1986 SC 1370)(supra) that in the facts of this case sections 3(1)(c) and 4(1)(c) of the Act are to be interpreted accordingly. The person generating and consuming energy were the same and the corporate veil should be lifted. In the facts of this case Hindalco and Renusagar were inextricably linked up together. Renusagar had in reality no separate and independent existence apart from and independent of Hindalco."

9) In case of **U.K. Mehra**(supra), Division Bench of Delhi High Court held that where a subsidiary is wholly owned by the principal company which has a pervasive control over it and the former acts as the hand and voice of the latter, the subsidiary in that event would be nothing but an instrumentality, rather a part, of the principal company. The two in that event would have to be treated as one concern. To come to such conclusions, the High Court applied the concept of lifting of corporate veil making following observations

"The submission of learned counsel for the petitioners that any arrangement between the third respondent and the Indian subsidiary would constitute a joint venture and would attract the restraint order passed by the learned single judge does not impress us. According to the application a wholly owned subsidiary of the third respondent will undertake software development, engineering services, technical services including installation and maintenance, both hardware and software development and training on a world wide basis including India. Where a subsidiary is wholly owned by the principal company which has a pervasive control

over it and the former acts as the hand and voice of the latter, the subsidiary in that event would be nothing but an instrumentality, rather a part, of the principal company. The two in that event would have to be treated as one concern. Contemporary trend shows that the lifting of the corporate veil is permissible whenever public interest so demands. Courts have been pragmatic in their approach in unveiling companies, especially the subsidiary companies to see their real face in the interests of justice."

15. From the above judicial pronouncements, it can be seen that 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.

16. 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 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.

17. 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 satisfaction of certain conditions, the directors can be held jointly and severally liable to pay the dues of the company.

18. 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 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. 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.

19. If these facts are duly established, we have no hesitation in holding that principle of lifting the corporate veil should be applied. By application of section 179 of the Act, the recovery of the tax dues of the company can be sought from the directors.

20. With respect to the finding of the Assistant Commissioner however, we have two reservations.

Firstly, it is nowhere pointed out from where or on basis of which material such findings have been arrived at. There are some far reaching observations and conclusions which would require thorough investigation and support from materials on record. For example, the Assistant Commissioner has recorded that the directors of the company have amassed substantial wealth in the form of immovable property. Full details of such properties, when they were acquired and whether there was any known source out of which the same were acquired is not known. This and many other observations of the Assistant Commissioner require further scrutiny and investigation.

21. Second dispute that we have with the Assistant Commissioner's order is that same suffers from gross violation of principles of natural justice. In his notice under section 179(1) of the Act, he only put the petitioner to notice that he proposed to hold him liable for recovery of the tax dues of the company. He neither mentioned nor disclosed any tentative reasons why he may also invoke the principle of lifting of corporate veil. When the petitioner replied to such a show cause notice and contended that the company being a public company, section 179 of the Act would not apply, the Assistant Commissioner while passing his final order, rejected such a contention by making detailed observations on the grounds on which principle of lifting the

corporate veil should be applied.

22.To our mind entire procedure was defective. Large number of observations have been made by the Assistant Commissioner in the said order without ever putting the petitioner to alert that because of certain prima facie materials at his command, he proposed to hold that the situation was such where the principle of lifting of corporate veil should be applied. It is true that after the Assistant Commissioner passed the said order on 15.4.2002, the petitioner made a detailed representation to the Assistant Commissioner raising several contentions why such principle could not be invoked. To our mind this would not cure the defect committed by the Assistant Commissioner. Firstly, the concept of post decisional hearing is not always accepted by the Courts and found to be rather unsatisfactory manner in which requirement of natural justice can be stated to have been fulfilled. Secondly even the Assistant Commissioner did not take into account such objections after passing his order and such objections thus remained pending. The petitioner did file revision against the order of the Assistant Commissioner and the Commissioner did examine his objections, however, there was no opportunity whatsoever to the petitioner to demonstrate before the authorities that the factors which have weighed with the Assistant Commissioner to invoke the principles of lifting the corporate veil do not arise at all. Thirdly,

in the matter of this nature where due to its extreme complexity of the transactions and law required to be applied, it would be highly unsatisfactory manner of eliciting the response from a citizen and dealing with the same. In the context of conflicting theories of requirement of hearing before taking adverse decision and for not insisting on such requirement rigidly when no prejudice is caused by non hearing, the Apex Court in case of **Canara bank and others v. Shri Debasis Das and others** reported in AIR 2003 Supreme Court 2041, referred to Lord Ackner who had stated that "'useless formality theory' is a dangerous one and, however inconvenient, natural justice must be followed" because, "convenience and justice are often not on speaking terms".

As held by series of decisions including in case of **Canara bank and others** (supra), in a case where breach of natural justice is noticed, the proceedings cannot be terminated for all times to come, but would have to be revived from the stage where the defect is noticed.

23. Our conclusions therefore, are as follows :

1) The respondent authorities did establish that it was not possible to recover the tax dues from the company.

2) The petitioner neither pleaded nor succeeded in establishing that such non recovery was not attributable to any gross neglect, misfeasance or

failure in discharging duty on his part in connection with the affairs of the company.

3) Being a public company, ordinarily, provisions of section 179(1) of the Act cannot be applied. However, if the factors noted by the Assistant Commissioner in his impugned order dated 15.4.2002 and highlighted by us in this judgement are duly established, it would certainly be a fit case where invocation of principle of lifting of corporate veil would be justified.

4) We however, hold that the Assistant Commissioner proceeded to record such findings without giving sufficient opportunity of hearing to the petitioner and without disclosing the necessary materials for coming to such a conclusion.

5) The impugned orders dated 15.4.2002 and revisional order dated 9.4.2003 are quashed.

6) The proceedings are however, placed back before the Assistant Commissioner for proceeding further in accordance with law after giving a notice to the petitioner indicating his tentative grounds why he desires to invoke the concept of lifting of corporate veil, giving sufficient opportunity to the petitioner to meet with such allegations. After giving opportunity of hearing to the petitioner and following the principles of natural justice it would be open for the

Assistant Commissioner to pass fresh orders in accordance with law as may be found appropriate on the basis of material on record.

24. With above directions, the petition is disposed of. Rule made absolute to above extent with no order as to costs.

(Akil Kureshi,J.)

(Harsha Devani,J.)

(raghu)