

Civil Misc. Writ Petition (Tax) No.311 of 2008

R.K. Chaddha and another Petitioner

Vs.

State of U.P. and others Respondents

Hon'ble Tarun Agarwala, J.

Hon'ble Dr. Satish Chandra, J.

By means of this writ petition, the petitioners have challenged the recovery notice dated 29th December, 2007 issued against them for recovery of the sales tax/ trade tax dues outstanding against the Company.

The facts leading to the filing of the writ petition is that petitioner no.1 is one of the Directors of the Company known as Vespa Car Company Ltd., which has a large number of share holders. Petitioner no.2 is the authorized representative looking after the trade tax matters of the Company and is not an employee nor is looking after the day to day affairs of the Company.

It transpires that an ex parte assessment order was passed against the company for the assessment year 1991-92 under the U.P. Trade Tax Act. Similarly, for the assessment year 1992-93, an ex parte assessment order was passed under the U.P. Trade Tax Act as well

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as under the Central Sales Tax Act. When the petitioner came to know about the ex parte orders, an application under Section 30 was filed for the recall of the ex parte assessment order and, at the same time, also preferred an appeal along with a stay application before the Joint Commissioner (Appeals), Trade Tax, Kanpur, which is alleged to be pending till date. It has also been stated that the application under Section 30 of the Act was rejected by an order dated 23rd November, 2007. Subsequently, a recovery notice dated 29th December, 2007 has been issued by the Assistant Collector (Collection), Trade Tax, Kanpur Nagar against the petitioners for recovery of the amount pursuant to the ex parte assessment order. The petitioners, being aggrieved by the said recovery notice, have filed the present writ petition.

We have heard Sri Subham Agarwal, the learned counsel for the petitioner and Sri C.B. Tripathi, the learned Special Counsel for the State-respondents.

The moot question which arises for consideration is whether the liability due against the Company can be fastened and recovered against the Directors of the Company. This question is no longer *res integra* and stand decided by a series of decisions of this Court.

In ***L. Parmeshwari Das Vs. The Collector of Bulandshahr, 1955 (6) STC 399*** it was held that recovery proceedings against a Company under the Sales Tax Act cannot be pursued against the private assets of the Directors of the Company. The Court

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restrained the authorities from proceeding against the private assets of the Directors of the Company. The said decision was followed in ***Satish Chand Singhal Kanpur and others Vs. Assistant Commissioner (Assessment) I Sales Tax, Kanpur and others, 1987 UPTC 473.***

In ***Shri Puroshottam Das Beriwal, Kanpur Vs. Deputy Collector (Collections), Sales Tax, Kanpur 1989 UPTC 456*** a Division Bench of this Court held that the liability against a Company can only be enforced against the assets belonging to the Company and not against the personal assets of the Directors. The Court held:-

“The cardinal principle of law is that when there is a liability against a company, no recovery can be made from personal assets of its Director, unless it is specifically provided in the Statute or warranted by law. It is not brought to our notice that there is any specific provision in the U.P. Sales Tax Act, whereunder recovery of the liability outstanding against a company can be made against the personal assets of its Director.”

The same view was reiterated by another Division Bench of this Court in ***Sudershan Kumar Gulati, Kanpur and others Vs. Deputy Collector (Collection), Sales Tax, Kanpur and others, 1994 UPTC 717*** wherein the Division Bench further held that in the absence of a specific provision like the one which exists in Section 79 of the Income Tax Act, 1961, the respondents could not be permitted to pursue their

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action against the erstwhile Director merely because they happened to manage the affairs of the Company during the period in respect of which the sales tax dues were outstanding. The Division Bench held that in view of the charging section, a dealer defined under Section 2 (c) of the U.P. Sales Tax Act, which includes a Company as well, was alone liable to pay the assessed tax. Similar view was held in ***G.C. Mehrotra Vs. Deputy Collector (Collection) Sales Tax, 1997 UPTC 1217*** and ***in Bheekhu Ram Jain Vs. State of U.P. and others, 2001 UPTC 364*** and in ***M/s Mahendra Kumar Jaipuria Vs. Commissioner, Trade Tax, U.P., Lucknow and another, VSTI 2007 AHC 150*** and again in ***Dr. Pawan Jain Vs. Commissioner, Trade Tax, U.P., Lucknow and another, VSTI 2007 AHC 152.***

In ***Smt. Uma Singhania, Kanpur and another Vs. Assistant Collector (Collection), Trade Tax, Kanpur and another, 2007 UPTC 654*** the Court held that in the absence of fraud being alleged to the effect that the Directors had siphoned off the funds of the Company, no recovery of the trade tax dues of the Company could be made from the personal assets of the Directors. The Court held that the liability of the shareholders as well as of the Directors was limited by shares and that if there were dues of the Trade Tax department against the Company, the department comes into the position of a secured creditor and can lodge a claim as a secured creditor in the liquidation proceedings.

In ***M/s Meekin Transmission Ltd., Kanpur Nagar***

and another Vs. State of U.P. and others, 2008 UPTC 600, a Division Bench of this Court held that the mere fact that the Company had failed to pay the government dues or public revenue by itself would not invite the doctrine of lifting the corporate veil and was not sufficient to ignore the statutory corporate body conferred upon a Company and make its directors or shareholders personally responsible. This view was followed by another Division Bench in **Nirmal Lal Agarwal and another Vs. Deputy Commissioner (Assessment) and others, 2009 NTN (41) 132** wherein the Division Bench went further to hold that if the tax dues are to be recovered from a corporate body, the Directors of such corporate body would not be automatically responsible unless the doctrine of lifting the veil was found to be applicable in the facts and circumstances of the affairs of the company. The Division Bench held that the Director of a shareholder cannot be made personally responsible for the dues of the company except in those cases where such a provision was made for in the statute or otherwise warranted by law.

Recently, a Division Bench of this Court has again reiterated the aforesaid view in **Kanwar Hasan Vs. State of U.P. and 2 others, 2014 NTN (54) 308** in which the Division Bench held that following the well settled principles of law, a Company has a separate juristic personality and since there is no provision in the U.P. Trade Tax Act, the dues of the Company could not be recovered from the personal assets of a Director.

On the other hand, the stand of the State is, that petitioner no.1 is not a guarantor but, being a Director and responsible to run the affairs of the company, was liable to satisfy the outstanding dues against the company, in the event, the dues could not be recovered from the assets of the company. The respondents contended that since the petitioner did not disclose that the assets of the company were still existing and that the outstanding dues could be realized from the aforesaid assets, the petitioner no.1 was liable to satisfy the outstanding dues against the company on account of wilful negligence or incompetency of the company. In support of his submission, the learned Standing Counsel placed reliance upon a decision ***Sanjay Kumar Gupta, Hatia, Kanpur Nagar Vs. District Magistrate, Fatehpur, 2004 (39) STR 31, Naresh Chandra Gupta, Kasganj, Etah, District Magistrate, Etah and others, 2004 (39) STR 37, Sri Ram Gupta, Kanpur Vs. Assistant Collector (Collection), Trade Tax, Section-II, Kanpur, 2004 (39) STR 64, and M/s Reflex Industries, NOIDA, Gautam Budh Nagar and another, 2004 (39) STR 576.***

The learned Standing Counsel has also placed reliance upon a decision of a Division Bench of this Court in ***Jagbir Singh Vs. State of U.P. and others, 2012 (50) NTN 236*** in which it was held that by lifting the corporate veil it can be found that the corporate personality was used as a mask for evasion of tax and that the corporate personality was sued to recover sham

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and collusive transactions and that when such tactics are used to circumvent the statutory liability, the taxes could be covered from the Directors by lifting the corporate veil inspite of absence of statutory provisions.

Having heard the learned counsel for the parties, the Court finds that the submission of the learned counsel for the State appears to be attractive in the first flush but, on a closer scrutiny, the Court finds that the doctrine of lifting the corporate veil is not applicable in the present facts and circumstances of the case.

The Company, in law has a separate legal entity of its own. Once incorporated, the entity of the Company is entirely separate from that of its shareholders. The Company has its own name, has its own seal, has its own assets and it can be sued or can sue for its own purposes. On the other hand, the liability of the shareholders is limited to the extent of its own shares, namely, to the extent of the capital invested by the shareholder. The creditors of the Company cannot obtain satisfaction from the assets of the shareholders of the Company and similarly, the shareholders have no right to the assets of the company. This position was recognized in ***Salomon Vs. Salomon and company Ltd., 1897 A.C. 22 HL*** and, since then, this principle has been consistently being followed till date.

In due course of time, certain exceptions were carved out in the doctrine of separate juristic personality of the company. The doctrine of lifting the corporate veil was carved out to be used whenever and wherever the

situation so warranted. Lord Denning in ***Littlewoods Stores Vs. I.R.C., 1969 (1) WLR 1241*** held:-

“ The doctrine laid down in Salomon's case has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the Courts cannot see. But that is not true. The Courts can, and often do, draw aside the veil. They can, and often do, pull off the mask. They look to see what really lies behind. The legislature has shown the way with group accounts and the rest. And the Courts should follow suit.....”

Since then, the doctrine of lifting of the corporate veil has been firmly established in a series of cases. The corporate veil could be lifted when it is found that the corporate personality was used as a mask for evasion of tax where transactions were found to be a sham or collusive or where the corporate personality was employed to circumvent statutory liability or to evade the tax liability. In such a situation, the veil could be lifted to find out the real culprits hiding behind it. It was held that even though there are no statutory provisions, the circumstances so existing in the particular case warrants the lifting of the corporate veil to realize the tax from the Directors or partners as the case may be as has been held in ***Telco & ors vs. State of Bihar AIR 1965 SC 40 (paras 24 & 27); CIT vs. Shree Minakshi Mills Ltd Madurai AIR 1967 SC 819 (para 8); New Horizon Ltd & another vs. Union of India and others (1995) 1 SCC 478; Delhi Development Authority vs. Skipper Construction Co. P. Ltd (1996) 4 SCC 622 (paras 24***

to 28); Calcutta Chromotype Ltd vs. Collector of Central Excise Kolkata AIR 1998 SC 1631 (para 12, 14); Shubhra Mukharjee & another v. Bharat Cooking Coal Ltd & another (2003) 3 SCC 312; Kapila Hingorani vs. State of Bihar JT 2003 (5) SC 1 (paras 25, 26, 27); Vodafone International Holding B.V. Vs. Union of India and others JT 2012 (1) SC 410 (para 167 & 168).

In **Shri Ram Shyam Shukla and others Vs. Asstt. Collector, Collection, Trade Tax, 2004 NTN (25) 768** this Court held that where circumstances so warranted, persons responsible for illegal acts and who were found to evade tax, the corporate veil could be lifted to recover the dues from the persons responsible for such illegal acts. The Court held:-

“4. We do not agree. The legal principle that a company is a distinct legal entity separate from its directors and shareholders (vide Soloman Vs. Soloman & Co. Ltd., 1897 A.C. 22 H.L.) was evolved to encourage business and industry since many businessmen feared to start a new business or venture because if the said business/ venture failed (due to competition, recession, etc.) even their personal assets could be attached and sold for the recovery in respect of the dues against the company. Hence his principle was created so as to encourage businessmen to take risks and set up industries and businesses and it has played a historical role in helping industrialization. This principle was not made to help tax evaders. As held by the Supreme Court in Delhi Development Authority Vs. Skipper Co. (P) Ltd. AIR

1996 SC 2005 (vide para 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.

5. The principle of lifting the veil of corporate personality has been upheld in Subhra Mukharjee & another v. Bharat Cooking Coal Ltd. & another (2003) 3 SCC 312; Calcutta Chromotype Ltd. vs. Collector of Central Excise Kolkata AIR 1998 SC 1631; New Horizon Ltd. & another vs. Union of India and others 1995 (1) SCC 478; C.I.T. vs. Meenakshi Mills Ltd. Madurai AIR 1967 SC 819; Telco & ors. vs. State of Bihar AIR 1965 SC 40; Juggilal Kamlapat vs. CIT, AIR 1969 SC 932.”

The legal position is, that in a case where the corporate personality has been obtained by certain individuals as a mask to prevent tax liability or to divert the funds of the Company for some illegal purpose, the corporate veil can be lifted so that the persons can be identified and made responsible and the tax liability of the Company could be recovered from the persons responsible for such fraud. However, this doctrine cannot be applied as a matter of course in a routine manner to recover the dues of a Company on the mere pretext that the dues are now not recoverable from the Company and, therefore, a resort has been made to

recover the dues of the Company from the personal assets of the Directors. If such a course is permitted, it will lead to disastrous results and would completely destroy the juristic personality of the Company. The principle of lifting the corporate veil is to find out as to who was responsible for committing the fraud and diverting the assets of the Company. It is not necessary that recovery has to be made against the Director or a promoter shareholder. The purpose of lifting the veil is to find out the person, who was operating behind the corporate personality for his personal gain.

In order to lift the corporate veil and fixing responsibility on a particular person or a Director the initial burden would be upon the department to allege and plead that the person concerned or the Director was personally responsible for playing a fraud upon the Company for his personal gains. It must be specifically pleaded that the corporate personality has been obtained as a pretext to cover up a transaction or intention of those persons, who was committing fraud or misrepresentation and, therefore, the legal personality of the corporate body should be ignored and the corporate veil should be lifted to find out the culprit and fix responsibility.

In the instant case, the only plea raised in the counter affidavit is, that petitioner no.1, being a Director, was responsible to run the affairs of the Company and was liable to satisfy the outstanding dues. Further, petitioner no.1 had not disclosed that any assets of the

Company was still existing from which the outstanding dues could be realized and, therefore, the petitioner no.1 was liable to pay the outstanding dues. No plea of fraud has been alleged nor there is any plea that petitioner no.1 was deliberately diverting the funds of the Company for his personal gains. There is also no plea against petitioner no.2, who was only the authorized representative of the Company looking after trade tax matters before the Trade Tax authorities. The initial burden was upon the department, which they have failed miserably. On the other hand, they have placed the burden upon the petitioner to indicate that the Company still has assets from which the department could recover. Such stand taken by the department is wholly misplaced and cannot be sustained.

From the pleadings it is apparently clear that the Company has filed an appeal against the ex parte assessment order, which is pending consideration. Consequently, the Company is still in existence. The substratum of the Company has not eroded. The mere fact that the Company has failed to pay the dues is by itself insufficient to invoke the doctrine of lifting the corporate veil and is not sufficient to ignore the statutory corporate personality conferred upon the Company.

The Court is of the opinion that when tax dues are to be recovered from the Company, the Directors would not automatically be responsible unless there is a statutory provision under the Act, which in the instant case is non-existent. In the instant case, the Court is

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further of the view that the doctrine of lifting the corporate veil is not applicable and that the petitioners cannot be made personally responsible for the dues of the Company.

Consequently, the impugned notice cannot be sustained and is quashed. The writ petition is allowed. We leave it open to the respondents to recover the amount from the Company and its assets.

Date:8.5.2014

Bhaskar

(Dr. Satish Chandra, J.)

(Tarun Agarwala, J.)