

(1989) 11 KL CK 0009

In the High Court Of Kerala

Case No : M.C.A. No. 478/89 in C.P. 7/79 in C.P. No. 7/79 in 4/80, M.C.A. 106/88 in C.P. 11/83 and C.A. 487 in C.P. 11/83

Canara Bank

APPELLANT

Vs

The Official Liquidator and Another

RESPONDENT

Date of Decision : 07-11-1989

Acts Referred:

Companies (Consolidation) Act, 1908 — Section 186, 209, 209(1)
Companies Act, 1913 — Section 230, 230(1), 232(2)
Companies Act, 1956 — Section 446, 446(1), 476, 529, 529A
Income Tax Act, 1961 — Section 178, 178(2), 178(3)
Transfer of Property Act, 1882 — Section 58A

Citation : (1989) 11 KL CK 0009

Hon'ble Judges : John Mathew, J

Bench : Single Bench

Advocate : T.R.G. Warriar, in in C.A. 478/89 in C.P. 7/79 and Sebastian Paul, M.C.A. 487/89 in C.P. 11/83 and Joseph Franklin, in M.C.A. 106/88 in C.P. 11/83, for the Appellant; K. Moni, for Official Liquidator and P.K.R. Menon and N.R.K. Nair for Income Tax Department, for the Respondent

Judgement

John Mathew, J.—The common question that arises in these applications is whether the income tax claim against a company in liquidation can be satisfied from out of proceeds of the sale of company's assets either as "cost, charges and expenses incurred in the winding up" u/s 476 of the Companies Act and/or as amount set aside u/s 178 of the Income Tax Act in priority to the claims u/s 529A of the Companies Act?

2. Company Application 478 of 1989 is filed by the Canara Bank for an order permitting the bank to appropriate a sum of Rs. 75,00,000 from out of the sale proceeds of the assets of Giovanola Binny Ltd. (in. liquidation) towards the amounts due to the bank from the said company. M.C.A. No. 37 of 1989 is filed by the Official Liquidator, who is the liquidator of the said company, for an order to sanction to declare a first dividend of 27 paise in the rupee to the creditors of the company under Sections 529 and 529A of the Companies Act. Notice of these

applications was given to the Income Tax Department. This Court passed order dated 30th March 1989 permitting the bank to appropriate a sum of Rs. 75,00,000 from out of the sale proceeds towards the amounts due to the bank under the loan transactions of M/s Giovanola Binny Ltd. (in liquidation). However, this Court made it clear that if it was found later that the balance amount is not sufficient to meet the claims, of the Income Tax Department as well as other claims it will be open to this Court to reopen this order and to direct the Bank to bring to the common pool the whole or any portion of the amount allowed to be appropriated. Subsequently by order dated 3rd July 1989 on M.C.A. 37 of 1989 this Court granted sanction to the Liquidator to declare a first dividend of 27 paise in a rupee as shown in Annexure A to the said application, to the creditors of the company under Sections 529 and 529A of the Companies Act. In the very same order this Court directed the Canara Bank to provisionally set apart Rs. 27,00,000 for capital gains tax on the basis of the representation of the learned Standing Counsel for the department. It was also made clear that the reservation made for capital gains tax will be subject to further order of this Court regarding the liability of the company and all matters connected with payment of capital gains tax.

3. In M.C.A. No. 106 of 1988 the applicant is a former employee of M/s Brunton and Company (Engineers) Ltd. (in liquidation). His prayer is to pay him the amounts due to him from the company. According to him there is no justification in setting apart Rs. 25,00,000 for payment of income tax of that company. The Liquidator has filed a counter statement stating that the applicant was paid two dividends aggregating to 27 per cent and therefore the prayer for further dividend cannot be allowed at this stage as there is no sufficient funds to the credit of the company.

4. Company Application No. 475 of 1989 is filed by the Canara Bank to direct the Official Liquidator in charge of M/s Brunton and Company (Engineers) Ltd. in liquidation to declare dividends u/s 529A of the Companies Act in respect of the sum of Rs. 25, 59, 526.50 now set apart as provision for payment of tax on capital gains. Notice of these applications was given to the Income Tax Department.

5. Application No. 487 of 1989 is filed by 41 applicants who were former employees of M/s Brunton and Company (Engineers) Ltd. (in liquidation) for payment of their claims from M/s Brunton and Company (Engineers) Ltd., (in liquidation) u/s 529A of the Companies Act. The Official Liquidator filed a counter statement in that application stating that he has set apart about 25-59 lakhs of rupees for paying capital gains tax and so this amount cannot be utilised to pay to the creditors unless issues relating to capital gains tax are settled in law.

6. In order to examine whether Income Tax will form part of the "cost, charges and expenses incurred in the winding up" and therefore u/s 476 of the Companies Act the court may make an order for the payment of tax in priority to other debts, it is necessary to examine the claims set up. The claim of the

workmen is u/s 529A of the Companies Act under which provision workmen's dues shall be paid along with the debts due to secured creditors in priority to all other debts, notwithstanding anything contained in any other provision of the Companies Act or any other law. The claim of the bank is as a secured creditor of both these companies, the properties sold having been mortgaged to the bank. The, instructive analysis of Rashbehary Ghose in his Tagore Law Lectures, Law of Mortgage (6th Edition, Page 61) is very much helpful to understand the word "mortgage".

A mortgage may be viewed in two aspects. In the first place it is a promise by the debtor to repay the loan and as such it is a contract which creates a personal obligation. Secondly it is also a conveyance, since it passes to the creditor a real right in the property pledged to him. However, the right created in the land is only an accessory right, intended merely to secure the due payment of the debt.

Section 58A of the Transfer of Property Act provides that a mortgage is the transfer of an interest in any immovable property for purpose of securing the payment of money. Then the question whether the mortgage right of the "bank will be subject to the claim of the State for income tax dues as cost of winding up has to be answered.

7. Sri P.K. Raveendranatha Menon, learned Senior Standing Counsel for Income Tax Department placed strong reliance on I.T.O. v. Official Liquidator, Swaraj Motors Ltd. 1976 KLT 850, where a Division Bench of this Court following the decision in re Beni Felkai Mining Co. 1934 ITR 309, held that before the assets are distributed among the creditors, income tax is payable as "costs, charges and expenses" incurred in the winding up. However Sri T.R. Govinda Warriar, learned Counsel appearing for Canara Bank pointed out that from the facts of that case it is evident that the court was not considering the claim for payment of income tax in priority to the claim of any secured creditor. More over Section 529A is a subsequent provision. This judgment was partly overruled in I.T.O. v. Official Liquidator, Palai Central Bank Ltd. 1985 KLT 416, where a Full Bench of this Court held that sanction of the winding up court u/s 446(1) of the Companies Act is required for realisation of income tax. Learned Counsel relying on the following authorities contended that the State can have no rights apart from what is provided in the Companies Act.

8. The House of Lords in Attorney-General v. De Keyser's Royal Hotel Ltd. (1920) A.C. 508, 526 held as follows:

The prerogative is defined by a learned constitutional writer as "The residue of discretionary or arbitrary authority which at any given time is legally left in the hands of the Crown". Inasmuch as the Crown is a party to every Act of Parliament it is logical enough to consider that when the Act deals with something which before the Act could be effected by the prerogative, and specially empowers the Crown to do the same thing, but subject to conditions, the crown assents to that, and by that Act to the prerogative being curtailed.

9. In *Food Controller and Anr. v. Cork* 1923 App Cases 463 the House of Lords again dealt with the question of priority of crown debts. Lord Wrenbury clarified the position as follows:

With this preface I go on to consider, first what is the prerogative or (if there be more than one) what are the prerogatives of the Crown, and, secondly, what is the operation of the statute in respect of them. The Crown, by virtue of its prerogative, is entitled to say: "In payment of debts I have the right to come first-and to enforce that right I can proceed by way of writ of extent." I should not myself describe this as two prerogative rights, of which one is larger than the other, but rather as one prerogative right and a prerogative remedy to enforce the right. I can understand that the Crown might surrender the latter, while retaining the former but not that it could surrender the former, while retaining the latter. If the right to come first is surrendered, the prerogative remedy to enforce that by writ of extent must have been surrendered also. The question for decision, therefore, I think is, and is only, whether the Crown has surrendered the prerogative right to come first. The effect of Section 209 is as follows: By Section 209(1)(a) certain Crown debts, which I will call the specified Crown" debts, are brought into the class of debts identified by Section 209(1)(a), (b), (c), (d). Debts of this class are to be paid "in priority to all other debts", in priority therefore, to (among others) the unspecified Crown debts. Subject to the priority right of this class, all liabilities are by Section 186 to be satisfied *pari passu*. The specified Crown debts, therefore are to be paid *pari passu* with the other debts in the class created by Section 209(1), and in priority to all other debts, whether Crown or not, which are not in that class. Further, all debts, whether Crown debts or not, which are not in that class are to be paid *pari passu* after satisfying the above priority. This is the statutory administration of the assets, and to this the Crown has given its assent. It follows from what I have said that the Crown is no longer in a position to say "I come first". It does not come first. Some debts have been raised by Section 209(1) to a position in which they rank with the specified Gown debts, and that class comes first. Other debts have been raised by Section 186 to a position in which they rank with the unspecified Crown debts, and these are to be postponed and to be paid *pari passu*. By assenting to an Act which altered the rights of the Crown in manner above stated, the Crown surrendered its prerogative light to come first, and necessarily surrendered also its prerogative light to enforce by a writ of extent a right of priority which existed no longer.

10. The Federal Court in AIR 1946 16 (Federal Court) while considering the general position of debts due to the Crown and the prerogative rights of the Crown in a liquidation of the company under Companies Act, 1913 relied on the opinion of Lord Wrenbury and held as follows:

We have no hesitation in coming to the conclusion and holding that the Crown is bound by the provisions of the Indian Companies Act, 1913 and is bound, in regard to the provisions relating to the Liquidation of companies, "to a statutory

scheme of administration wherein the prerogative right of the Crown to priority no longer exists." (Lord Wrenbury in 1923 A.C. 647, at p. 672). The Crown is accordingly not entitled, in our judgment to any prerogative, priority, of preferential rights or treatment, save those expressly conferred and limited by the Act itself, in particular by Section 230 and Sub-section (2) of Section 232.

11. Section 530(1)(a) of the Companies Act, 1956 is the provision corresponding to Section 209 of the Companies Consolidation Act, 1908 referred to in Food Controller and Anr. v. Cork 1923 App Cases 463, which is as follows:

530 (1) "In a winding up, subject to the provisions of Section 529A, there shall be paid in priority to all other debts-

(a) all revenues, taxes, cesses and rates due from the company to the Central or State Government or to a local authority at the relevant date as defined in Clause (c) of Sub-section (8), and having become due and payable within the twelve months next before that date:

(rest of the section omitted)

12. Thus it is clear that (i) this provision is subject to the provisions of Section 529A of the Companies Act and (ii) revenues, taxes, cesses and rates must have become due and payable within 12 months next before the relevant date, which is the date of appointment of provisional liquidator or the date of winding up as the case may be, in order that it may be paid in priority to other debts. Therefore the Income tax now claimed will not come within the purview of Section 530(1) (a) of the Companies Act, since the sales of the properties of the companies took place after passing of the winding up orders.

13. More over it has to be observed that the companies in liquidation had only a limited right over the properties which were sold, namely full title over the properties minus the mortgage right in favour of the Canara Bank. The Bank agreed for sale of the properties free of encumbrance subject to a first charge on the proceeds. In other words, what was sold was the right of the company as well as the mortgage right of the bank. Neither the companies in liquidation nor the State have any claim over the mortgage right of the bank. Section 529A of the Companies Act is the sole statutory provision which creates a right to the workmen on the mortgage right of the bank. Therefore only if there is any balance amount due after satisfying the claims of the secured creditor, namely the bank, is available, the State or other creditors are entitled to any share over the proceeds of the sale.

14. In Raja Bahadur Motilal Shivilal v. Poona Cotton and Silk Manufacturing Co. ILR 1942 Bom 215, the Bombay High Court considered the claims of secured creditor vis-a-vis expenses in liquidation. The court also examined the difference between expenses "incurred in the winding up" and expenses "incurred for realisation". Kemp, J. after observing that "the assets really are whatever remains over after the claims of the secured creditors under their securities have

been satisfied" held as follows (at page 220):

If, however, the District Judge's order is to be taken as expressing what he undoubtedly meant, viz. that the first charge for the proposed loan was to have priority over the mortgages of the Plaintiff and second Defendant then I am of opinion that that order was not only wrong but passed entirely without jurisdiction. The District Judge could not by any order passed on that petition take away the rights of secured creditors without their consent. The sections of the Indian Companies' Act cited by Mr. Mulla regarding preferential payments and the priority of payment out of the assets of a company of the costs and expenses of winding up refer only to the fund available as assets, i.e., after the claims of secured creditors have been satisfied. If the liquidators themselves realise property subject to a specific charge the proceeds are distributable in priority of the following order, viz., firstly, to the costs of realisation; secondly, in payment of the costs of preservation, strictly so described, so far as the other assets of the company are not sufficient; and thirdly, in payment of the principal, interest and mortgagees' costs, all of which have priority over the general costs of the liquidation and the costs of the carrying on the business of the company.

This judgment was confirmed by the appellate judgment of Scott, C.J. (at page 221).

15. Rashbehary Ghose In Tagore Law Lectures, Law of Mortgage (6th Edition, page 388) relying on various authorities has observed that "It seems a Government debt in India is not entitled to precedence over a prior secured debt".

16. Section 476 of the Companies Act provides that the court may make an order for payment out of the assets of the costs, charges and expenses incurred in the winding up, in such order of priority inter se as the court thinks just. The meaning of the word "assets" can only mean the asset of the company in liquidation. It will not include the mortgage right which is an asset of the bank. However, Section 529A has created a new priority in respect of workmen and secured creditors. Even if Income Tax is treated as winding up cost, it can be paid only from out of the assets of the company. It cannot be paid from out of the mortgage right which does not belong to the company in liquidation. In *Re Mesco Properties Ltd.* (1980) 1 All E.R. 117, Buckley L.J. observed as follows:

The company is liable for the tax which is due. The tax ought to be paid. The liquidator is the proper officer to pay it. When he pays, he will clearly make a disbursement. In my judgment it will be a necessary disbursement within the meaning of the rule. Moreover, common sense and justice seem to me to require that it should be discharged in full in priority to the unsecured creditors, and to any expenses which rank lower in priority under Rule 195. The tax is a consequence of the realisation of the assets in the course of the winding up of the company. That realisation was a necessary step in the liquidation; that is to say, in the administration of the insolvent estate. The fact that in the event there may be nothing available for the unsecured creditors does not in my view, mean

that the realisation was not a step taken in the interests of all who have claims against the company. Those claims must necessarily be met out of the available assets in due order of priority.

17. The following extract of the recommendation of the Company Law Committee in paragraph 218 of their report will throw considerable light on the reasons for the changes in the provisions relating to preferential payment:

In this connection we should like to refer to a memorandum that we received from the Central Board of Revenue, on the question of a priority to be given to crown demands generally and, in particular, to arrears of Income tax Super tax, and Corporation tax. It was suggested that there should be no time-limit for the preferential payment of these crown debts and that Section 230 of the Indian Companies Act should be amended accordingly. The practical difficulty of giving effect to the suggestion is that it would place a great majority of the unsecured creditors of the company at the mercy of the Income tax authorities, inasmuch as, whatever may be the nature of the security on which they may have lent money to a company at the time of the loan, the unforeseeable demands of the Income tax authorities on the company without any time limit would rank over the claims of such creditors. In these circumstances, it may be extremely difficult for the company to raise capital for its working. In this connection, we would draw attention to the provisions of Clause (a) of Sub-section (1) of Section 319 of the English Companies Act, 1948, under which arrears of land tax, Income Tax, profits tax, excess profits tax or other assessed taxes rank in priority over other debts of a company only if they have been assessed on the company up to a particular date, namely 5th April or prior to the appointment of the liquidator or resolution for the winding up of the company and do not exceed in amount the whole of one year's assessment. It will be noticed that by comparison the provision of Clause (a) of Sub-section (1) of Section 230 of the Indian Companies Act, is much wider and gives much more latitude to the Income tax authorities for under these provisions, arrears of taxes would rank in priority if they have become due and payable within twelve months next before the date on which they are payable irrespective of whether such taxes have been assessed on the company or not. We are aware of the large arrears of income and other taxes which are due by many companies, which are in liquidation, but we would venture to think that the remedy for this unsatisfactory situation is not the conferment of preferential rights without limit to the Income tax authorities u/s 230 of the Indian Companies Act, but the energetic completion of assessment proceedings and vigorous measures for the collection of the assessed taxes.

18. The purpose of Section 529A is to ensure that the workmen should not be deprived of their legitimate claims in the event of the liquidation of the company. By this provision the workmen's dues and the secured creditor's dues which rank *pari passu* should be paid in priority to all other debts. The workmen are statutorily allowed to recover their dues from the securities. If the securities are insufficient, the claims of the workmen and the secured creditor would abate in

equal proportions. In other words, by Section 529A the workmen of the company in liquidation have been made secured creditors in respect of their claims against the company and the assets of the company in liquidation would remain charged for the payment of workmen's dues and such charge will be pari passu with the charge of the secured creditors. There is no statutory provision over-riding the claims of secured creditors excepting Section 529A of the Companies Act. From the above discussion it has to be held that the contention that Income tax must be paid as cost of winding up, in priority to the claims of the workmen and secured creditor, cannot be allowed.

19. Claim u/s 178 of the Income Tax Act.- Although learned standing Counsel for Income Tax Department stated that as a matter of fact the assessing officer did not serve on the liquidator any notification u/s 178(2) of the Income Tax Act, since learned Counsel on both sides advanced elaborate arguments on the claim of the department u/s 178 of the Income Tax Act, a brief reference to the arguments advanced on either side appears to be necessary. A Full Bench of the Kerala High Court in Imperial Chit Funds Ltd.(In Liquidation) Vs. Income Tax Department, , held that the effect of Section 178(3)(b) of the Income Tax Act, 1961 is that "the amount "set aside" by the liquidator of a company is marked off as being outside the area of the winding up proceedings and the jurisdiction of the winding up court". The Full Bench relied on I.T.O. v. Indian Traders Bank Ltd. 1968 KLT 595 (which judgment was confirmed in the unreported decision in A.S. No. 224 of 1968) for holding that "(1) that the amount "set aside" is outside the scheme of winding up; and (2) that the Income Tax Department is put practically in the same position as a secured creditor, and gets, so to say, a first charge on the amount due", even though Raman Nayar, J., as he then was, had in his judgment in Indian Traders Bank's case 1968 KLT 595, observed that the payments to the secured creditor "are really not so much cases of priority as of the particular asset not being available for distribution among the creditors in the winding up" and it "stand on the same footing as, for example, trust funds". It may be mentioned that Civil Appeal No. 1199 (N.T.) of 1979 against the Full Bench judgment in Imperial Chit Funds Ltd.(In Liquidation) Vs. Income Tax Department, , pursuant to the certificate granted by that Bench is pending before the Supreme Court. It is clear that neither Section 178 of the Income Tax Act nor any provision in the Companies Act confers priority to Income Tax in winding up proceedings. The preferential payment provided u/s 530(1)(a) is limited and is subject to the provisions of Section 529A. The report of the Company Law Committee referred to earlier shows that the request for priority was specifically raised and it was not recommended by the committee. Section 178 is a procedural one and cannot be taken as a provision conferring priority for Income Tax. In fact the Full Bench was not dealing with secured creditors and their claims.

20. So also Section 446 of the Companies Act was not considered by the Full Bench. u/s 178 of the Income Tax Act the assessing officer is making only an estimate and not passing an order of adjudication. There is no provision to

challenge a notification u/s 178(2) of the Income Tax Act. The judgment of the Supreme Court in S.V. Kondaskar, Official Liquidator and Liquidator of the Colaba Land and Mills Co. Ltd. Vs. V.M. Deshpande, Income Tax Officer, Companies Circle I(8), Bombay and Another, , where it was held as follows, was not brought to the notice of the Full Bench which considered the Imperial Chit Funds Ltd.(In Liquidation) Vs. Income Tax Department, .

The liquidation court would have full power to scrutinise the claim of the revenue after Income tax has been determined and its payment demanded from the liquidator. It would be open to the liquidation court then to decide how far under the law the amount of income tax determined by the department should be accepted as a lawful liability on the funds of the company in liquidation. At that stage the winding up court can fully safeguard the interests of the company and its creditors under the Act.

The Full Bench decision of this Court in E.L.J. Rebello and Others Vs. Commissioner of Agricultural Income Tax and Another, , has upheld the jurisdiction of the winding up court in the matter of recovery of income tax.

21. The object of Section 178 seems to be to reserve sufficient assets of the company in liquidation for paying income tax dues and not giving any right of priority to income tax dues in addition to Section 530(1)(a) of the Companies Act. In any view of the case Section 529A is a subsequent provision which confers rights on secured creditors and workmen notwithstanding anything contained in any other provision of the Companies Act or any other law for the time being in force. However, in this case it is not necessary to decide the question since the assessing officer has not notified the official liquidator to set aside any amount from the assets of both these companies.

22. In C.A. No. 478 of 1989 relating to Giovanola Binny Ltd. (in liquidation) there will be a direction to the official liquidator to declare a further dividend in respect of the amount of Rs. 27 lakhs provisionally set apart as per order of this Court in M.C.A. 37 of 1989, to the workmen and to the Canara Bank u/s 529A of the Companies Act. Before doing so, the liquidator will reimburse to the Canara Bank the amounts advanced by the bank to the liquidator and the expenses incurred by them which will be ordered separately.

23. In M.C.A. 106 of 1988, C.A. 475 of 1989 and A. No. 487 of 1989 in respect of M/s Brunton and Company (Engineers) Ltd. (in liquidation) the liquidator is directed to declare a further dividend u/s 529A of the Companies Act in respect of the sum of Rs. 25,59,526-50 to the workmen and to the Canara Bank after reimbursing the Canara Bank the amounts advanced by the bank to the liquidator and the expenses incurred by the bank which will be ordered separately.

24. Applications disposed of accordingly.

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