

(1978) 08 KL CK 0019

In the High Court Of Kerala

Case No : Report No. 53 in C.P.No. 7 of 1973

Imperial Chit Funds Ltd.(In Liquidation)

APPELLANT

Vs

Income Tax Department

RESPONDENT

Date of Decision : 10-08-1978

Acts Referred:

COMPANIES ACT, 1956 — Section 156, 17, 446, 447, 448

Income Tax Act, 1961 — Section 178, 220

Provincial Insolvency Act, 1920 — Section 47

Citation : (1979) 116 ITR 176

Hon'ble Judges : Gopalan Nambiyar, C.J

Bench : Single Bench

Judgement

This Judgment has been overruled by : Imperial Chit Funds (P) Ltd. Vs. Income Tax Officer, Ernakulam, (1996) 3 AD 488 : AIR 1996 SC 1887 : (1996) 1 BC 659 : (1996) 86 CompCas 555 : (1996) 133 CTR 505 : (1996) 219 ITR 498 : (1996) 3 JT 410 : (1996) 3 SCALE 20 : (1996) 8 SCC 303 : (1996) 3 SCR 640

Gopalan Nambiyar, C.J.—The Imperial Chit Funds (P.) Ltd., is a private company which was wound up as per orders dated June 1, 1973 of this court on C. P. No. 7 of 1973, filed by a creditor. After winding up commenced, proceedings for assessment for the year 1972-73 were finalised by the ITO by his order dated March 31, 1975. A sum of Rs. 934 was assessed as tax payable by the company and Rs. 93 as interest payable under s. 220(2) of the I. T. Act. The total amount thus payable was Rs. 1,027. The official liquidator of the company intimated the ITO by his letter dated May 8, 1975, that tax and interest constituted a debt provable in the winding-up proceedings and he was not in a position to pay the amounts straightaway. The tax was due and payable within twelve months before the relevant date mentioned in s. 530(8)(c) of the Companies Act - vide s. 530(1) (a) of the Act. A notice to pay the amount was received from the TRO on December 8, 1976; whereupon, the official liquidator filed Report No. 53 seeking the direction of court that the tax claimed is not payable at this stage, as the ITO will have to wait and prove his claim when the list of creditors is settled; and that

the interest amount was not payable as it was against the provisions of the Companies Act and the Rules. A learned judge of this court referred to the judgment of this court in A. S. No. 224 of 1968 (Offl. Liq., Indian Traders Bank Ltd. v. ITO) which had taken the view that the amount set aside under s. 178 of the I. T. Act will not be available for distribution in accordance with the provisions of the Companies Act, and that therefore there was no question of any priority in the distribution of assets. The learned judge felt that certain aspects of the company law were apparently not brought to the notice of the court and that the decision required reconsideration. The learned judge referred to the view taken in some of the other High Courts that s. 178 of the I. T. Act does not affect or alter the existing law of priority; nor override the provisions for preferential payment under s. 530 of the Companies Act. Reference was made to the decisions of the Gujarat High Court in Baroda Board and Paper Mills Ltd. (In Liquidation) Vs. Income Tax Officer, Circle I, Ward-e, Ahmedabad and Others, , Income Tax Officer, Company Circle, Bangalore Vs. Official Liquidator, Mysore High Court and Others, , Official Liquidator, Official Liquidator, High Court, Calcutta Vs. Commissioner of Income Tax, West Bengal, , and Commissioner of Income Tax (Central) and Another Vs. Official Liquidator, Golcha Properties (Pvt.) Ltd. (In Liquidation) and Another, . As against these, the Andhra Pradesh High Court in Income Tax Officer, B-Ward Vs. Official Liquidator, had taken a view similar to the one in A. S. No. 224 of 1968. It was in view of this, that the question was adjourned for hearing by a Division Bench and the Division Bench in its turn adjourned the matter for hearing by a Full Bench.

2. S. 446 of the Companies Act provides that when a winding-up order has been made or the official liquidator he been appointed as provisional liquidator, no suit or other legal proceeding shall be commenced or proceeded with against the company except by leave of court. Counsel for the official liquidator drew our attention to s. 447 of the Act that the effect of a winding-up order shall operate in favour of all the creditors and all the contributories as if it had been made on the joint petition of all of them. He also invited our attention to ss. 448(a), 449, 451 and 456(2), 457(e), 511, 528 and 529 of the Act to show that after the winding-up, the official liquidator is in full charge of the assets of the company, is to conduct or proceed on behalf of the company, and that all the property and the assets of the company are in the custody of the court. He referred next to s. 178 of the I. T. Act which reads:

178. (1) Every person-

(a) who is the liquidator of any company which is being wound up, whether under the orders of a court or otherwise; or

(b) who has been appointed the receiver of any assets of a company, (hereinafter referred to as the liquidator) shall, within thirty days after he has become such liquidator, give notice of his appointment as such to the Income Tax Officer who is entitled to assess the income of the company.

(2) The Income Tax Officer shall, after making such inquiries or calling for such information as he may deem fit, notify to the liquidator within three months from the date on which he receives notice of the appointment of the liquidator the amount which, in the opinion of the Income Tax Officer, would be sufficient to provide for any tax which is then, or is likely thereafter to become, payable by the company.

(3) The liquidator-

(a) shall not, without the leave of the Commissioner, part with any of the assets of the company or the properties in his hands until he has been notified by the Income Tax Officer under sub-section (2); and

(b) on being so notified, shall set aside an amount equal to the amount notified and, until he so sets aside such amount, shall not part with any of the assets of the company or the properties in his hands:

Provided that nothing contained in this sub-section shall debar the liquidator from parting with such assets or properties for the purpose of the payment of the tax payable by the company or for making any payment to secured creditors whose debts are entitled under law to priority of payment over debts due to Government on the date of liquidation or for meeting such costs and expenses of the winding up of the company as are in the opinion of the Commissioner reasonable.

(4) If the liquidator fails to give the notice in accordance with sub-section (1) or fails to set aside the amount as required by sub-section (3) or parts with any of the assets of the company or the properties in his hands in contravention of the provisions of that sub-section, he shall be personally liable for the payment of the tax which the company would be liable to pay:

Provided that if the amount of any tax payable by the company is notified under sub-section (2), the personal liability of the liquidator under this sub-section shall be to the extent of such amount.

(5) Where there are more liquidators than one, the obligations and liabilities attached to the liquidator under this section shall attach to all the liquidators jointly and severally.

(6) The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force.

It was pointed out that the section unless properly delimited would set at naught the whole scheme and the object and the provisions of the Companies Act regarding winding up. It was also contended that s. 178 does not confer a right of priority in respect of all Income Tax dues, nor recognise any preferential claim in favour of the ITO. S. 530 of the Indian Companies Act, which provides for preferential payment, provides by cl. (a) the preference to which revenue, tax, cesses, etc., are entitled in the following terms:

530. Preferential payments. - (1) In a winding up, 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 a 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.

3. In the light of the above provisions, the argument of counsel for the liquidator, in effect, was, that the ITO had no right to call upon the liquidator at this stage to pay the amount of the Income Tax; nor was the liquidator bound to pay the same, and that the right of the ITO or the Income Tax department was to seek *pari passu* payment in the winding-up proceedings in the company court. This is the principle of the decisions on which counsel for the liquidator placed reliance to which we shall now refer.

In *Baroda Board and Paper Mills Ltd. (In Liquidation) Vs. Income Tax Officer, Circle I, Ward-e, Ahmedabad and Others*, , a Division Bench of the Gujarat High Court surveyed the position and held that under s. 530(1)(a) of the Companies Act, priority was extended only to taxes "due" and "payable" by the company. These expressions, it was held, meant that the amount must be presently payable. It was held that the Income Tax for a particular assessment year becomes a debt due to the Crown only when the tax is calculated and assessed and thereafter a demand is made under the relevant provisions of the Act. It was only in this sense that the words in s. 530(1)(a) had to be interpreted. It was further ruled that s. 178 of the I. T. Act did not sanction any priority of payments, and that the same is provided only in the Companies Act. The provision in s. 178 of the I. T. Act only required the liquidator to intimate the ITO about his appointment, and the latter to give notice to the liquidator of the approximate amount that would suffice to meet the demand for any tax "then due, or likely to become due". It does require the liquidator not to part with any assets of the company, until he had been notified by the ITO under sub-s. (2), and on being so notified, he is to "set aside" the amount equal to what has been notified; and until he thus sets aside, he is not to part with any of the assets of the company. The Gujarat High Court pointed out that the provision for setting aside did not require the liquidator to give priority to the Income Tax liability different from the order of priority indicated by s. 530(1)(a) of the Companies Act; and that the provisions of s. 178(6) did not interfere with s. 530(1)(a). It was pointed out that s. 17 of the CST Act, 1956, was in terms similar to, if not identical with, s. 178 of the I. T. Act, and that with respect to the same, the same principle had to be followed. In the result, it was held that all sales tax due in respect of which assessment orders were made within a period of twelve months, from the relevant date, would have priority; but those beyond the said date would not qualify for any priority and it would not be open to the liquidator to pay up the liabilities under the demand unless the claims are scrutinised and ascertained and the dues paid under orders of the liquidation court. The

liquidation court had to decide how far the amounts, of tax liability due by the department should be accepted as a lawful liability. It was held that the sales tax authorities were not entitled to recover the amount of sales tax or penalties. This, in substance, is the principle of the ruling of the Gujarat High Court. It emphasised the meaning of the expression "due and payable" as explained in judicial decisions. We have noticed the sense in which these words were explained. The decision noticed the passage in Sampath Iyengars Income Tax, 6th edn., at page 1732, with respect to s. 178(6) of the I.T. Act. The learned author observed that under the provisions of the Act, a tax is payable only after notice of payment being served on the assessee under s. 156, and, therefore, the priority under the Companies Act is restricted only to cases where the notice has been served under s. 156 within the period of one year immediately preceding the relevant date under s. 530(8) of the Companies Act. Thus, in the view of the author though an order of assessment might have been made before the commencement of the winding up, still no priority would attach unless the notice of payment under s. 156 had been served on the assessee. The learned author noted that the section secured for revenue, priority of payment over all unsecured creditors, for taxes payable in respect of periods up to the date of commencement of liquidation or date of appointment of receiver. In regard to s. 178(6), the learned author observes that the section secures to the revenue, priority of payment over all unsecured creditors, of taxes payable in respect of all periods up to the date of commencement of liquidation or the date of appointment of receiver. In respect of taxes due for the years subsequent to the commencement of liquidation or the appointment of a receiver, according to the learned author, there was no provision made in the I. T. Act or the Companies Act. After noticing the above view of Shri Sampath Iyengar, the learned judges of the Gujarat High Court disagreed with the authors interpretation of s. 178(6) of the Act. The learned judges were of the view that s. 178 did not sanction any priority of payments which is provided in the Companies Act, and all that s. 178 requires is the giving of information by the liquidator about his appointment to the ITO and an intimation by the ITO within three months of the date of intimation, about the approximate amount needed to cover the tax liability. The learned judges were of the view that there is nothing in s. 178 which provides for a rule of priority for the said tax liability, and, therefore, the non-obstante clause in s. 178(6) did not interfere with s. 530(1)(a) of the Companies Act.

4. We have referred to the Gujarat decision at some length as it has examined in detail the relevant decisions and the relevant aspects arising for consideration. Practically the same view has been expressed by the Mysore High Court in *Income Tax Officer, Company Circle, Bangalore Vs. Official Liquidator, Mysore High Court and Others*, , by the Calcutta High Court in *Official Liquidator, High Court, Official Liquidator, High Court, Calcutta Vs. Commissioner of Income Tax, West Bengal*, and by the Rajasthan High Court in *Commissioner of Income Tax (Central) and Another Vs. Official Liquidator, Golcha Properties (Pvt.) Ltd. (In Liquidation) and Another*, . With respect, these decisions fail to take note of the

object and purpose with which s. 178 of the I. T. Act was put into the statute book; and the significance and the implications of "setting aside" of an approximate amount needed to meet the tax liability of the company. These have been noticed in the Kerala and the Andhra decisions to which we shall refer. Before we do so, we may briefly indicate that the effect of s. 178(3)(b) is that the amount "set aside" by the liquidator is marked off as outside the area of the winding-up proceedings and the jurisdiction of the winding-up court. This is the view taken by the Kerala High Court and we are in agreement with it; especially because, the legislative history to which we shall refer, clearly brings to light the scope and the purpose of s. 178 of the Act. We refer in the first place to the report of the Company Law Reform. This is referred to by the Andhra High Court in its decision which we shall notice presently. The report is seen extracted at page 770 of Ramaiyas Guide to the Companies Act, 7th end. We extract the relevant passage:

S. 230 of the Act of 1913 deals with the important subject of preferential payment. The principle underlying this section is that the debts liabilities enumerated in it should be treated as preferential debts as compared with ordinary unsecured debts. The rights of secured creditors other than debenture-holders secured by a floating charge are not affected in any way. They remain outside the scope of the winding up proceedings and their security remains unaffected by the provisions of this section. We have set out in the Annexure to our report the details of our recommendations, which broadly follow the provisions of the English Companies Act. Briefly, the more important of these recommendations are as follows:

(i) the position of clerks, servants and labourers, who are workmen (vide cls. (b) and (c) of sub-s. (1) of s. 230) are brought in line;

(ii) the maximum amount of wages or salaries in respect of which preferential claim should be admissible is increased from three to four months emoluments, subject to a maximum of Rs. 1,000. We recommend that holiday wages should be included within the definition of wages or salary, subject to this maximum;

(iii) expenses of any investigation, carried out under any of the provisions of the Act, should rank for the preferential payment.

In this connection we should like to refer to a memorandum that we received from the CBR, 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 s. 230 of the Indian Companies Act should be amended accordingly. The practical difficulty of giving effect to this suggestion is that it would place a great majority of the unsecured creditors of the company at the mercy of the I. T. 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 unenforceable demands of the I. T. 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 cl. (a) of sub-s. (1) of s. 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 cl. (a) of sub-section (1) of s. 230 of the Indian Companies Act, is much wider and gives much more latitude to the I. T. 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 I. T. authorities under s. 230 of the Indian Companies Act, but the energetic completion of assessment proceedings and vigorous measures for the collection of the assessed taxes.

It is after the said report that we get the provision in s. 530(1)(a) of the Companies Act, 1956. The Committee's recommendation was not completely accepted by the legislature. Next, we have the report of the Direct Taxes Administration Enquiry Committee, seen extracted in Srinivasan's Book on Income Tax Law. Vol. II, at p. 345. S. 178 was based on the recommendation of the Direct Taxes Administration Enquiry Committee which in paragraph 5.62 of its report, stated as follows:

Generally, the I.T. authorities are hardly aware of the winding up proceedings and by the time they gain the information and complete the assessment, the assets of the company might have been distributed with the result that taxes become irrecoverable. It was pointed out that in certain instances the assets of a company have been hastily distributed and the name of the company got struck off from the register by the Registrar of Companies. To get such a company restored to the register requires costly and prolonged litigation. Under such circumstances, placing specific obligations on the liquidator to intimate the fact of his appointment and also insisting on his securing a tax clearance certificate before the assets of a company are distributed or compel him to set apart assets of the value equal to the tax that may be due or may become due, as may be intimated by the ITO appear to be necessary.

The historical evolution of this branch of the law thus shows that s. 230 of the Indian Companies Act, 1913, and the decision of the Federal Court in *Shiromani Sugar Mills case* [1946] 14 ITR 248; [1946] 16 Comp Cas 71 (FC) are to the effect that the State is not entitled to priority in respect of tax dues. Then we

have the Company Law Committee Report and s. 530(1)(a) of the Companies Act, 1956. Next, we get the recommendation of the Direct Taxes Administration Enquiry Committee followed by the substitution of the present sub-ss. (3) and (4) of s. 178 of the I.T. Act in the place of the former ones. We take note also of the view of Kanga (p. 1086 of Vol. I) that the provisions of the Act do not confer any priority on the I.T. department.

5. We may now conveniently refer to the decision of Raman Nayar J. (then Actg. C.J.) of this court in *ITO v. Indian Traders Bank Ltd.* [1968] KLT 595. Observed the learned judge:

One wishes that s. 178 of the I.T. Act, 1961, were more explicit, but, as I read that provision, I do not think that it affects the scheme of priority in s. 530 of the Companies Act although its effect no doubt is that the amount set aside under sub-s. (3) thereof has first to be applied to the satisfaction of the tax liability and in that sense the tax liability gets priority over the other debts of the company in the same way as a secured creditor who stands outside the winding up or whose security is redeemed, under sub-s. (4) of s. 47 of the Provincial Insolvency Act read with s. 529 of the Companies Act, gets priority to the extent of the value of his security. But, although sub-s. (3) of s. 178 of the I.T. Act, which speaks of the liquidator making payment to secured creditors whose debts are entitled under law to priority of payment over debts due to Government-the only payment I can think of by the liquidator to a secured creditor who has not relinquished his security is a payment under sub-s. (4) of s. 47 of the Provincial Insolvency Act, or to a creditor who, although he has not relinquished his security, has agreed to the liquidator selling the property free of his incumbrance on condition of his being given the same charge over the sale proceeds-seems to regard these as cases of priority, they 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. They stand on the same footing as, for example, trust funds. What is really available for distribution are the assets which come into the hands of the liquidator minus the trust monies, or the incumbrance of a secured creditor, or, in a case falling under s. 178 of the I. T. Act, the amount set aside or earmarked for the payment of the tax. For, reading sub-ss. (2), (3) and (4) of that section together there can be no doubt that what the section does is to create a first charge on the amount set aside by sub-s. (3) thereof for payment of the tax that might be admitted to proof.

We see a blending of two strands of reasoning in the passage quoted above : (1) that the amount "set aside" is outside the scheme of winding up; and (2) that the I.T. department is put practically in the same position as a secured creditor, and gets, so to say, a first charge on the amount due. Regarding the non-obstante clause, the learned judge observed:

And, if this brings the section into conflict with s. 530 of the Companies Act, the section must prevail by reason of sub-s. (6) thereof - the question why Income Tax alone of all Government dues should ride this high horse is not for me to

answer. But, for the purposes of s. 530 of the Companies Act, the tax liability is an ordinary and not a preferential claim and it is only out of the amount set aside under sub-s. (3) of s. 178 of the I. T. Act., that the revenue can claim payment of its debt to the exclusion of other creditors.

The decision was carried up in appeal and confirmed by a Division Bench of this court in A. S. No. 224 of 1968 (Offi. Liq., Indian Traders Bank Ltd. v. ITO). The learned judges after noticing ss. 178 and 530 of the Companies Act observed that the latter section did not sanction any preferential claim for Income Tax dues over the other debts mentioned in s. 530. Referring to the arguments of the official liquidator about the absence of any provision in s. 178 of the Act directing that the amount "set aside" must be paid to the ITO, and that, therefore, the amount so set aside must also be available for distribution in accordance with the scheme of the Companies Act, the Division Bench observed:

We no doubt see that these are weighty arguments and it is these aspects arising from the wording of the section that has made the section rather ambiguous and made its interpretation difficult. As against these provisions, however, we cannot ignore the provision in sub-s. (2) of s. 178 that the amount to be notified is not only the amount for which preference is given under s. 530 of the Companies Act, 1956, but the entirety of the Income Tax dues of the company including that which may thereafter become payable. When we read this provision with the provision in sub-s. (4) of s. 178 of the Act which makes the liquidator personally liable for the payment of the tax which the company would be liable to pay if the liquidator failed to give notice in accordance with sub-s. (1) of s. 178, it appears to us that the provision in s. 178(3) imports much more than what was contended by counsel for the appellant. This is the view that has been taken in the judgment under appeal which, if we may say with great respect deal with all aspects in a few sentences. We respectfully agree with the view taken by the learned judge.

The dictionary meaning of the words set aside in its legal aspect is the same as that of the words set apart. These words mean keeping separate for a special purpose. It is difficult, therefore, to give any other meaning to the words set aside under s. 178(3) than that the amount set aside is for the object of meeting the Income Tax dues. It necessarily follows that it is not available for any other purpose. If it is utilised for being distributed in accordance with the provisions of the Companies Act, the whole of it will not be available for the payment of Income Tax. This will be against the provisions of s. 178(3). We agree with the learned judge that the question is not really one of priority but a question as to whether this amount is available for distribution under the scheme of the Companies Act, 1956. If the matter is one of priority, of course the non-obstante clause in s. 178(6) of the Act will be attracted. But, we prefer to rest the decision on the ground that the amount set aside under s. 178 of the Act will not be available for distribution in accordance with the provisions of the Companies Act, 1956.

We wish to emphasise the meaning of the expression "set aside", which has been noticed in the Andhra decision in *Income Tax Officer, B-Ward Vs. Official Liquidator*, . According to the *Corpus Juris Secundum*, Vol. 80, p. 1, "to set aside" or "to set apart" means no more than "to designate" and means "to separate to a particular use". In common terminology "set aside" or "set apart" has been held to be synonymous with "appropriate". According to *Corpus Juris Secundum*, Vol. 6, p. 121, "set aside" means "to set apart or apply to a particular purpose". The shades of meaning thus attached to the expression "set aside" convey the idea of an appropriation or an allocation of the Income Tax dues; with the result, that it stands outside the winding up by the company court, an idea suggested in the judgment of Actg. Chief Justice, Raman Nayar, confirmed by the Division Bench. The Andhra decision has referred to the Company Law Committee Report which seems to have been responsible for s. 530(1)(a) of the Companies Act; but did not refer to the report of the Direct Taxes Administration Enquiry Committee, to which we have referred earlier.

6. We may contrast the difference in phraseology between s. 530(1)(a) of the Companies Act and s. 178(2) read with sub-s. (3) (b) of the I. T. Act. Under the earlier section, the priority extends to all taxes "due and payable" within twelve months before the relevant date, which means only taxes which have crystallised into a liability as against the assessee. But under s. 178(2) the amount to be notified by the ITO covers any tax "which is then, or is likely thereafter, to become, payable by the company". The range of liability is much wider in s. 178(4).

7. Counsel for the official liquidator complained that after having "set aside" the amount, as required by s. 178(2), there is no provision for the balance left in the hands of the official liquidator after making a final adjustment of the tax liability, to be dealt with by the company court, We do not think that this position envisaged by counsel is correct. S. 555 of the Companies Act seems to us to be wide enough to deal with the situation. Read in the light of s. 511, we see no difficulty in the matter.

8. Counsel for the liquidator raised an objection to the claim for interest based on r. 179 of the Companies (Court) Rules, 1959. We see no substance in the objection. S. 220 of the I.T. Act clearly provides for interest in specified contingencies; and the "setting aside" directed by s. 178 of the Act would include a claim for the same.

9. In the result, we see no warrant to grant the prayers made by the liquidator in his report. We reject the prayers made in the report. There will be no order as to costs.