

(1998) 06 KAR CK 0035

In the Karnataka High Court

Case No : Writ Petition No"s. 30791 to 30793 of 1995

Murthy Associates

APPELLANT

Vs

Tax Recovery Officer and Others

RESPONDENT

Date of Decision : 22-06-1998

Acts Referred:

Income Tax Act, 1961 — Section 281
Transfer of Property Act, 1882 — Section 53, 53 (1)
Wealth Tax Act, 1957 — Section 34 B

Citation : (1999) 153 CTR 283 : (1998) 234 ITR 30

Hon'ble Judges : V.K. Singhal, J

Bench : Single Bench

Advocate : S. Parthasarathy, for the Appellant; M.V. Seshachala, for the Respondent

Judgement

V.K. Singhal, J.—The petitioner is a partnership firm constituted by deed dated April 1, 1986. Theresa V. Murthy and P. J. Fernandez were the partners. Fernandez brought the property No. 44, Wellington Street, Civil Station, Bangalore, in the firm as contribution of his capital and Mrs. Murthy brought the property bearing No. 44/1, Wellington Street, Civil Station, Bangalore, as her capital. The firm was reconstituted on November 4, 1987, and Mr. Ghazenfer Basha was admitted as one of the partners. Again on March 2, 1988, Mr. Munavar Basha was admitted as partner and P.J. Fernandez retired from the firm. Mrs. Theresa V. Murthy also retired on March 23, 1991. P.J. Fernandez expired on March 7, 1990, and Mrs. Fernandez has also expired. Thereafter, a notice dated July 4, 1994, was served on the petitioner-firm that Mr. P.J. Fernandez was in arrear of Income Tax of Rs. 1,56,87,000. Property No. 44/1, Wellington Street, Civil Station, was attached on July 4, 1994. Objections were filed. Appeal under rule 86 of the Second Schedule to the Act was also filed which is stated to be pending. Directions were given in W. P. No. 29804 of 1994 to dispose of the said appeal. An order dated January 2, 1995, was passed u/s 281 of the Income Tax Act and Section 34B of the Wealth-tax Act, 1957. Writ Petitions Nos. 8467 and

8468 of 1995 against the sale proclamation in respect of properties Nos. 44 and 44/1 were filed in which it was observed that the petitioner could raise objection before the respondent. Objections under Rule 11 of the Second Schedule, Part I of the Act were filed by the petitioner. The sale proclamation dated July 18, 1995, has been assailed in these petitions besides the orders which have been passed u/s 281 of the Income Tax Act and Section 34B of the Wealth-tax Act.

2. According to the respondents, the arrears of Rs. 1,56,87,000 were for the assessment year 1977-78 and onwards and even notices have been served in ITCP-1 in 1983. The Tax Recovery Officer informed the petitioner-firm that the formation of the partnership in 1987 and retirement after taking a sum of Rs. 6 lakhs being after service of notice ITCP-1, the formation of partnership or alienation of the property is contrary to rule 16 of the Second Schedule to the Income Tax Act.

3. In the order passed by the Income Tax Officer u/s 281, dated January 2, 1995, it was observed that huge arrears were outstanding in respect of the assessment years 1973-74 to 1981-82 (WT) and 1977-78, 1982-83 and 1983-84 (IT) before April 1, 1986, the day when the partnership firm was constituted contributing the immovable property as their capital without prior permission from the Department or obtaining the certificate u/s 230A of the Act which was with the intention to defraud the Revenue. The firm so constituted had no business transaction till retirement. Notices u/s 281 were served on Michael Fernandez, legal representative of P.J. Fernandez as also Mrs. Theresa Murthy, Ghazenfer Basha and Munavar Basha, the present partners of the firm. No objections were filed and accordingly it was held that the transfer of property No. 44, Wellington Street, Bangalore, by the late P.J. Fernandez on April 1, 1986, to the firm Murthy Associates was void u/s 281 of the Income Tax Act, 1961. Similar orders u/s 34B of the Wealth-tax Act, 1957, were also passed.

4. Learned counsel for the petitioner has raised only one controversy before me during the course of his argument, viz., whether Section 281 of the Income Tax Act has contemplated passing of an order or the order passed on January 2, 1995, is without jurisdiction ? Reliance is placed on the decision of this court in the case of B.A. Basith Vs. Income Tax Officer, Central Circle-I, Bangalore, . The following observations were made (page 435) :

"The section by itself does not contemplate making of any order by any authority. It is declaratory in nature. It declares that transfers effected by any assessee with intent to defraud the Revenue during the pendency of any proceedings under the Act shall be void against any claim in respect of any tax or other sum payable by the assessee "as a result of the completion of the said proceedings". Therefore, three requirements under the section are, (i) that there must be a transfer of property, (ii) that it should be during the pendency of a proceeding under the Act, and (iii) that the transfer must be with intent to defraud the Revenue, and if these conditions are satisfied then the transfer shall be void in respect of any tax or sum payable by the assessee as a result of the

completion of the proceedings during the pendency of which the transfer was effected. The effect of the section is that if such transfer with intent to defraud the Revenue has been made and any claim for tax arises after the completion of the proceedings during the pendency of which the transfer took place, such tax or other sum can be recovered by proceeding against the property notwithstanding the said transfer. There is no question of adjudication of validity of the transfer prior to the stage of actual recovery of any amount that may become due consequent on the pending proceedings being completed. After the proceedings are completed and if payment is not made and proceedings are taken for recovery by proceedings against certain properties and such recovery is objected to by the assessee or the transferees and it is contended that the transfer was with intent to defraud the Revenue, then such dispute will have to be adjudicated. Rules, under Schedule II to the Income Tax Act, provide for adjudication of such claims. It is, therefore, clear that the declaration or order made by the Income Tax Officer at this stage is without the authority of law."

The above judgment was considered by this court again in the case of K. Siddalingaiah v. ITO [1982] TLR 550, wherein the following observations were made (page 551) :

"A similar question arose for consideration by this court in the case of B.A. Basith Vs. Income Tax Officer, Central Circle-I, Bangalore, . Srinivasa Iyengar J., who decided that case has held that Section 281 of the Act by itself did not contemplate making of any order by any authority. That it was declaratory in nature. He further held after pointing out the essential ingredients of the section that it was not for the assessing Income Tax Officer to make an order under that section as the question to be investigated in respect of transfers would arise only after the proceedings were concluded and the assessed tax remained unpaid. He, therefore, held that a declaratory order made by the Income Tax Officer at the stage of assessment would be without the authority of law."

On the basis of the above two judgments, it is stated that Section 281 has not contemplated passing of an order and, therefore, the order passed by the Income Tax Officer, is non est, without jurisdiction and liable to be quashed on that ground alone. Reliance is also placed on the decision in the case of Gangadhar Vishwanath Ranade (No. 1) and others Vs. Income Tax Officer, . It is also pointed that a SLP against the said judgment is pending in the apex court. On the basis of these judgments, it is stated that the Income Tax Officer has no jurisdiction to pass an order.

5. In order to consider the argument of learned counsel for the petitioner the provisions of Section 281 are to be examined which are as under :

"Certain transfers to be void.--(1) Where, during the pendency of any proceeding under this Act or after the completion thereof, but before the service of notice under Rule 2 of the Second Schedule, any assessee creates a charge on, or parts with the possession (by way of sale, mortgage, gift, exchange or any other mode

of transfer whatsoever) of, any of his assets in favour of any other person, such charge or transfer shall be void as against any claim in respect of any tax or any other sum payable by the assessee as a result of the completion of the said proceeding or otherwise :"

The condition precedent for exercise of power u/s 281 are : (1) that the power could be exercised before service of notice under Rule 2 of the Second Schedule when the proceedings are pending under Income Tax Act or even after the completion thereof ;

(2) a charge is created or parting with the possession by way of sale, mortgage, gift, exchange or any other mode of transfer of asset in favour of any other person, the charge is deemed to be void against any claim in respect of any tax or other sum payable by the assessee as a result of completion of the said proceedings or otherwise-Section 281 as reproduced above was substituted by the Taxation Laws (Amendment) Act, 1975, with effect from October 1, 1975. The interpretation which learned counsel for the petitioner is taking of the judgment given by this court is not the correct interpretation of law. The case of B.A. Basith Vs. Income Tax Officer, Central Circle-I, Bangalore, was interpreted in the case of K. Siddalingaiah [1982] Tax LR 550, where it was considered that the order made by the Income Tax Officer u/s 281 at the stage of assessment declaring the transfer made by the assessee void is without the authority of law. Section 281 does not require passing of the order and it is by fiction of law that any such transfer just to defraud the Revenue is void. The provision is considered to be declaratory in nature. This is a declaration of law for which no formal order is required. But it does not mean that the Income Tax Officer cannot pass an order as in the case of B.A. Basith Vs. Income Tax Officer, Central Circle-I, Bangalore, in the above observations it is mentioned that "it is, therefore, clear that the declaration or order made by the Income Tax Officer, at this stage is without the authority of law." In this case, it was found that there were no proceedings pending at the time of transfer and, therefore, the Income Tax Officer could not have inferred that the transfers were with the intention to defraud the Revenue. The learned judge found it unnecessary to consider the question of merits as to whether the Income Tax Officer was justified in coming to the conclusion that the transfers were made with an intent to defraud the Revenue at that stage. It was observed that if specific demands are raised and sought to be recovered from the properties and persons interested put forth their claims against such recovery then an adjudication is to be made. Section 281 is an enabling provision by virtue of which a declaration is made that the transfer is ineffective and void so far as the Income Tax Department is concerned. Such statutory provisions for declaring the transfers, as void, exist in other statutes also. The Income Tax Department being the creditor and having the statutory right to declare the transaction as void can do so. There may be transactions which are considered as not void as mentioned in the proviso with which we are not concerned. The transfer is not void ab initio. If the sale is made of a property to a third person and the provisions of Section 281 are applicable, if the demand

is paid the creditor/income tax Department will have no objection and the transaction would be valid in law, The transfer is void only to the extent of arrears of tax due from the assessee concerned, who has created the charge or effected the charge. The observations in the case of B.A. Basith Vs. Income Tax Officer, Central Circle-I, Bangalore, , therefore, to the extent that the section does not contemplate making of an order has to be considered in the light of the facts of that case. Since there were no arrears or proceedings pending on the date of transfer, the Income Tax Officer could not have passed the order. When the section itself stands considered to be declaratory in nature, a declaration has to be made and that declaration gives only the jurisdiction to the Income Tax authority to bring on record his intention to proceed for recovery in respect of arrears of tax against the said property. A certificate for recovery has to be sent by the Income Tax Officer under Rule 2 of the Second Schedule. Under Rule 11 of the said Schedule investigation with regard to the claim or objections could be filed by the parties which have already been filed. Any order passed by the Tax Recovery Officer is final, subject to filing of the civil suit as provided under Rule 11(6) of the Rules. It is pointed out that a civil suit is pending before the civil court.

In McDowell and Co. Ltd. Vs. Commercial Tax Officer, , the Supreme Court observed that (headnote) :

"The evil consequences of tax avoidance are manifold. First, there is substantial loss of much needed public revenue, particularly in a welfare State like ours. Next, there is the serious disturbance caused to the economy of the country by the piling up of mountains of black money, directly causing inflation. Then there is "the large hidden loss" to the community by some of the best brains in the country being involved in the perpetual war waged between the tax avoider and his expert team of advisers, lawyers and accountants on the one side and the tax gatherer and his, perhaps not so skilful, advisers, on the other side. Then again there is the "sense of injustice and inequality which tax avoidance arouses in the breasts of those who are unwilling or unable to profit by it". Last, but not the least, is the ethics of transferring the burden of tax liability to the shoulders of the guideless, good citizens from those of the "artful dodgers"."

In Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat, , wherein the Supreme Court observed that (page 523) :

"If the transfer of the personal asset by the assessee to a partnership in which he is or becomes a partner is merely a device or ruse for converting the asset into money which would substantially remain available for his benefit without liability to Income Tax on a capital gain, it will be open to the Income Tax authorities to go behind the transaction and examine whether the transaction of creating the partnership is a genuine or a sham transaction and, even where the partnership is genuine, the transaction of transferring the personal asset to the partnership firm represents a real attempt to contribute to the share capital of the partnership firm for the purpose of carrying on the partnership business or is

nothing but a device or ruse to convert the personal asset into money substantially for the benefit of the assessee while evading tax on a capital gain. The Income Tax Officer will be entitled to consider all the relevant indicia in this regard, whether the partnership is formed between the assessee and his wife and children or substantially limited to them, whether the personal asset is sold by the partnership firm soon after it is transferred by the assessee to it, whether the partnership firm has no substantial or real business or the record shows that there was no real need for the partnership firm for such capital contribution from the assessee. All these and other pertinent considerations may be taken into regard when the Income Tax Officer enters upon a scrutiny of the transaction, for, in the task of determining whether a transaction is a sham or illusory transaction or a device or ruse, he is entitled to penetrate the veil covering it and ascertain the truth."

The Bombay High Court in *Inayat Hussain Vs. Union of India*, , it was considered that the proceeding can be pending, viz., (i) for the finalization of tax liability of the assessee ; (2) for finalisation of default proceedings for failure on the part of the assessee, and (3) finally for recovery on his failure to pay the demanded tax by him and all these proceedings must be construed to be pending u/s 281. The provisions of Section 281 were held applicable to movable as well as immovable assets. Section 281 and Rule 16 of the Second Schedule were considered to be operative in different fields. In *Smt. Preeti Rungta v. ITO* [1995] 214 ITR 954, the Calcutta High Court has also considered that the section is declaratory and not procedural in the sense that it does not provide for any mode for any enforcement of the rights created under this section. It was considered corresponding to Section 53 of the Transfer of Property Act. The Bombay High Court in *Gangadhar Vishwanath Ranade (No. 1) and others Vs. Income Tax Officer*, observed that the order passed under 281 was not an order in the proper sense of the term as it did not decide anything but merely demonstrated and recorded an intention on the part of the Revenue to proceed against the property of the defaulting assessee. It was observed (page 173 of [1989] 177 ITR) :

"Neither Section 281 of the Income Tax Act nor Section 53, Sub-section (1) of the Transfer of Property Act declares a transfer to be void ab initio so that the title of the transferee is gone. It merely says what the law is. It is, therefore, really a substantive declaration of what the law of the land is. In the absence of Section 281, recourse could certainly be had to the provisions of Section 53, Sub-section (1) of the Transfer of Property Act. But, as is clear, that would apply only in cases of transfers of immovable property. The Legislature, in its wisdom, thought it necessary to introduce Section 281 in the Income Tax Act. The question, however, is whether by introducing Section 281 in the Income Tax Act, 1961, the Legislature wanted to confer a power and jurisdiction which was exclusive upon the Income Tax authorities or otherwise. In other words, the question is whether Section 281 as found in the Income Tax Act which is *pari materia* with Section 53(1) of the Transfer of Property Act only declares what the law is, or whether Section 281, by its placement in the Income Tax Act, provides

a complete adjudicatory machinery for the Income Tax Department to declare a transfer as fraudulent, whether of movable or immovable property. We are unable to think that Section 281, in the form in which it was, or in the form in which it is after its amendment in the year 1975, does anything further, except saying as to what the law is in respect of transfers effected during the pendency of any proceedings under the Income Tax Act, which come within the mischief and circumstances laid down in Section 281. It does not thereby say that any conclusion or declaration by an authority entrusted with the functions to be performed under the Income Tax Act will operate as conclusive or adjudicatory. It merely has the character of an expression of an intention or opinion on the part of such authority, that it intends to treat the transfers as affected by Section 281 and, therefore, not standing in the way of recovery proceedings to be taken by the Tax Recovery Officers."

The Punjab and Haryana High Court in B.M. Kapoor (HUF) Vs. Deputy Commissioner of Income Tax, observed (page 705) :

"... from a reading of Section 281, it is clear that any transfer by the assessee during the pendency of any proceedings under the Act or after completion thereof shall be void against any claim in respect of any tax or any other sum payable by the assessee as a result of the said proceeding or otherwise. Thus, it is clear that the transaction or the transfer is not void ab initio. Section 281 only declares that any transfer is void against the claims of the Revenue in respect of the tax finally determined in a proceeding which has been pending at the time of the transfer. Section 281 does not say that even after the transfer of the property the ownership continues to be with the assessee till all the claims of the Revenue are satisfied. Section 281 does not declare the transfer to be void ab initio so that the title of the transferee is lost. It only declares that the transfer is void to the extent of the tax liability that might finally be determined by the authorities on completion of the proceeding under the Income Tax Act. In fact, no separate orders u/s 281 are also required to be passed to give effect to the provisions of Section 281 as it is declaratory in nature and it does not require any adjudication on the nature of the transfer and the rights of the parties to the transaction in general."

From the various decisions and the plain language of the section, the following principles emerge :

- (1) That the provisions of Section 281 of the Income Tax Act, are declaratory by statute itself.
- (2) That for the purpose of proceedings against a property which has been transferred or on which a charge is created, for an intention of the Income Tax Officer to proceed against the said property could be by passing an order u/s 281. Even if the order is not passed the transfer contrary to Section 281 would be void against the Revenue. If the order is passed it will be considered to be only a declaration of the intention of the Revenue authorities to proceed against

the said property.

(3) The dispute could be agitated by the Tax Recovery Officer under Rule 11 of Schedule II to the Income Tax Act and the finality is given to the order passed by the civil court under Rule 11(6).

In view of the above, I do not consider at this stage that there is any necessity to declare the order passed by the Income Tax Officer as without jurisdiction more particularly when a civil suit has been filed and is pending which will finally determine the rights of the parties. Petitions stand disposed of with the above observations.