
(1972) 03 RAJ CK 0007

In the Rajasthan High Court

Case No : Company Miscellaneous Application No. 2 of 1972 in Company Petition No"s. 9 and 10 of 1966

Official Liquidator, Golcha Properties Private Ltd. (In Liquidation)

APPELLANT

Vs

Income Tax Officer and Others

RESPONDENT

Date of Decision : 22-03-1972

Acts Referred:

Companies Act, 1956 — Section 446, 446(1), 446(2), 460(4), 530
Income Tax Act, 1961 — Section 178

Citation : (1974) 44 CompCas 144 : (1974) 94 ITR 11 : (1972) WLN 563

Hon'ble Judges : P.N. Shingal, J

Bench : Single Bench

Advocate : R.K. Rastogi and H.C. Rastogi, U.C. Jain, for the Appellant; G.C. Sharma, Randhir Chawla, S.K. Kackar and P.K. Bhansali for respondent No. 1 and S.C. Bhandari, for the Respondent

Judgement

P.N. Shingal, J.—This is an application of the official liquidator under Sections 446 and 460(4) of the Companies Act, 1956, hereinafter referred to as " the Act ", in regard to the Golcha Properties Private Ltd , hereinafter referred to as "the company". The official liquidator was appointed as the provisional liquidator of the company on December 5, 1967, and an order was made for the winding up of the company on May 10, 1968, when the official liquidator became the liquidator. The Income Tax Officer issued notice, annexure " I ", to the liquidator on August 29, 1968, notifying him u/s 178 of the Income Tax Act, 1961, that he should set aside a sum of Rs. 41 lakhs on account of the taxes payable, or likely to be payable by the company. The liquidator sent reply, annexure " II ", requesting the Income Tax Officer to obtain the leave of this court u/s 446 of the Act as the company was under liquidation by the order dated May 10, 1968. The Income Tax Officer did not, however, pay any heed to that request and reminded the liquidator that his attention had already been drawn to Section 178 of the Income Tax Act in the earlier communication. When the further effort of the

liquidator to arrive at a workable arrangement with the Income Tax authorities did not succeed, he filed the present application challenging the validity of the Income Tax Officer's notice, annexure " I ", and asking for the directions of this court. In doing so, the liquidator has pointed out that the Income Tax Officer has issued the notice (annexure "I") without making any enquiry or calling for any information from him, without hearing him, and without even informing him of the basis on which he has been required to set aside the amount of Rs. 41 lakhs for the payment of the Income Tax. It has been pointed out that the Income tax Officer had preferred a claim for Rs. 41 lakhs, but it was admitted only to the extent of Rs. 1,12,583 as an ordinary claim and the balance of the claim amounting to Rs. 39,87,417 was rejected for the reasons stated in the liquidator's order dated October 30, 1971. An appeal has been preferred against that order, and it will be disposed of separately, but it is not disputed before me that no part of the debt claimed on account of Income Tax had become " due and payable " within twelve months next before the date of the appointment of the provisional liquidator so that the Income Tax department is not in a position to claim a preferential payment u/s 530 of the Act in priority to the other debts. It may also be mentioned that the Income Tax authorities did not care to assess the Income Tax for the assessment years 1959-60 and 1960-61 until 1964 and even then the tax assessed for those years was " nil ". The tax for the assessment year 1961-62 was assessed at Rs. 6,83,808 as late as March 26, 1966, while the tax for the assessment year 1962-63 was assessed on March 29, 1967. Even those last two assessments were set aside on appeal on May 11, 1967 and March 15, 1971. It will thus appear that nothing substantial was done by the department by way of quantification or collection of the Income Tax over a period of some 9 years, until the appointment of the provisional liquidator, when they suddenly woke up and became aware, within a period of a few months after the appointment of the liquidator, that the company, which was being wound up as a bankrupt company, was liable to pay Rs. 41 lakhs to the department by way of Income Tax. It has been pointed out by the liquidator in this connection that even though the debt claimed on account of Income Tax is not entitled to any priority over the other debts in accordance with Section 530 of the Act, the Income Tax Officer has gone to the extent of issuing the notice, u/s 178 of the Income Tax Act for setting aside such a huge sum as Rs. 41 lakhs for the payment of the Income Tax in preference to all the other debts of the company which, it is admitted before me, amount nearly to a crore of rupees. It has, therefore, been urged by the liquidator that the work of winding up of the company has been held up on account of the arbitrary notice of the Income Tax Officer, and he has prayed that it should be quashed and proper directions given u/s 460(4) of the Act.

2. The Income Tax Officer, who is respondent No. 1 in this application, has filed a reply to the application, in which he has challenged the jurisdiction of this court to entertain and adjudicate upon the application of the liquidator on the ground that the Income Tax Act is a special enactment and is a code by itself. He has

also taken the plea that Section 178 of the Income Tax Act " creates a charge upon the assets of the company in the hands of the liquidator securing thereby the recovery of such taxes as may become due and payable by the company after the liquidator has been appointed". Reference in this connection has been made to Sub-section (6) of Section 178. The respondent has, however, admitted that the details or the break-up of the amount of Rs. 41 lakhs mentioned in the notice annexure " I ", had not been furnished to the liquidator, and that the leave of the court was not taken for the purpose of issuing the notice. According to him, no such leave was necessary. He has denied that he did not make any enquiry or collect any information before issuing the notice, and has stated that he had gone through the record which showed that all such enquiries as were necessary for the purpose of estimating the liability for the pending assessment years had already been made. The source from which these enquiries were made has, however, not been disclosed. Then the respondent has stated as follows :

" Further", the clear object and purport of introducing a provision like Section 178 of the Income Tax Act, 1961, was to safeguard the recovery of tax from a company in liquidation on the basis of priority even though the assessments were yet pending."

3. It has been urged in this connection that the provisions of Section 178 of the Income Tax Act override the provisions of the Act, including Section 530. Then he has stated that even though the liquidator had informed him of his desire to declare the first dividend in the course of the winding up of the company, he was " resisting " that effort " in the interest of the revenue by urging that the demands of the revenue should be predominant consideration with the petitioner ". It is quite clear, and is in fact admitted before me, that the impugned notice (annexure " I") has been given by the Income Tax Officer to safeguard the recovery of the Income Tax " on the basis of priority " over the other debts of the company. The respondent has stated further that the point raised by the liquidator is not a matter relating to the winding up of the company and has not arisen in the course of the winding up.

4. It will thus appear that, although the Income Tax Officer was aware that a winding up order had been made, he notified the liquidator, without the leave of the court, that he should set aside Rs. 41 lakhs on account of the taxes payable or likely to be payable under the Income Tax Act. He has in fact paid no heed to the liquidator's suggestion that he should take the leave of this court u/s 446 of the Act, and the Income Tax authorities have not thought it proper to withdraw the notice even though the liquidator had pointed it out to them that the liability for the tax was not a preferential debt and would rank pari passu with the other ordinary creditors of the company. The liquidator has thus been required to set aside Rs. 41,00,000 for the payment of the Income Tax, and no part of this amount is, therefore, available for payment to the other creditors of the company including those who are entitled to preferential payment u/s 530 of the Act. The question for consideration is whether this is permissible under the law ?

5. This, in turn, raises the question of the applicability of Section 446(1) of the Act which reads as follows :

"446. (1) When a winding-up order has been made or the official liquidator has been appointed as provisional liquidator, no suit or other legal proceeding shall be commenced, or if pending at the date of the winding-up order, shall be proceeded with, against the company, except by leave of the court and subject to such terms as the court may impose."

6. The object of the sub-section has been stated as follows in Palmer's Company Law, twenty-first edition, page 768, with reference to Section 231 of the English Companies Act of 1948 which is quite similar :

" The object of the winding-up provisions of the Companies Act, 1862, said Lindley L.J. in *In re Oak Pits Colliery Co.* [1882] 21 Ch.D. 322, 329 (C.A.). is to put all unsecured creditors upon an equality and to pay them part passu. To accomplish this it was indispensable that proceedings against the company by way of action, execution, distress or other process should be suspended; otherwise the winding-up would resolve itself into a scramble for the assets."

7. It is in fact well settled that the assets of a company in liquidation are held in trust for all the parties entitled, and even if one cestui que trust is able to get possession of a part of the trust property, he must bring it in for distribution with the remaining creditors in accordance with the provisions of the Act.

8. Not all the creditors are, however, alike, and Section 530 of the Act provides for preferential payments. It will be sufficient to say for purposes of the present controversy that, subject to the retention of such sums of money as may be necessary for the costs and expenses of the winding up, the debts on account of all revenues, taxes, cesses and rates due from the company to the Central Government at the date, of the first appointment of a provisional liquidator, which became due and payable within the twelve months next before that date, have to be discharged forthwith along with the other debts requiring preferential payment so far as the assets are sufficient to meet them. But the other, debts due on account of revenues, taxes, cesses and rates are not entitled to preferential payment and rank *pari passu* with the other ordinary debts. This provision is in marked contrast to the provisions contained in the Insolvency Acts which allow the priority in respect of all debts due to the State or a local authority. The difference is significant and meaningful. Under the provisions of the Act it is not, therefore, permissible for the court to permit proceedings which would, in fact and substance, give priority to any creditor, including the State, who is not entitled to it. This view was expressed in *The Bank of Bihar Ltd. Vs. Secy. of State and Others*, and has been approved in *Governor-General in Council v. Shiromani Sugar Mills Ltd.* [1946] 16 Comp. Cas. 71 : 14 I.T.R. 248 ; AIR 1946 16 (Federal Court)

9. There can be no change in this basic legal proposition even if leave of the court is obtained u/s 446(1) or, for that matter, under Sub-section (1) of Section

537 of the Act, notwithstanding the provisions of Sub-section (2) of Section 537. Sub-section (2) of Section 537 reads as follows :

" (2) Nothing in this section applies to any proceedings for the recovery of any tax or impost or any dues payable to the Government. "

10. It, therefore, provides that if any attachment, distress or execution is put in force without the leave of the court, or any sale is held without such leave, it shall not be void in so far as it relates to the recovery of any tax or impost or any dues payable to the Government. This has led Mr. Stiarna, learned counsel for respondent No. 1, to argue that the impugned notice (annexure " I ") will, at any rate, be quite legal under Sub-section (2) of Section 537 for it is only a proceeding for the recovery of the Income Tax. It will be sufficient to say, however, that there is nothing in the sub-section which could be said to provide an overriding priority for the recovery of any tax or impost or any dues payable to the Government in addition to the priority permissible u/s 530 of the Act. In other words, Sub-section (2) of Section 537 cannot be interpreted to mean that once the Income Tax is determined, it will be permissible for the Income Tax Officer to proceed to recover it without the leave of the court and in violation of the rule of priority stated in Section 530. Moreover, the legal position regarding the recovery of Income Tax after its quantification has been considered by their Lordships of the Supreme Court in *S. V. Kondaskar, Official Liquidator, and Liquidator of the 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, Their Lordships have dealt with the dispute regarding the reassessment of Income Tax without the leave of the court u/s 446(1) of the Act in respect of a company which had been ordered to be wound up and after examining the legal position at length, they have considered the question of " collection " of the Income Tax and agreed with the view expressed in *Mysore Spun Silk Mills Ltd., In re: (In Liquidation) Official Liquidator Vs. Commissioner of Income Tax, Bangalore*, that leave of the court is necessary u/s 446 of the Act and that realisation of the tax will be governed by the Act. The following observations of their Lordships of the Supreme Court will serve to negative the argument of Mr. Sharma and it will not be necessary for me to examine it any further :

" 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. "

11. Reference in this connection may also be made to the decisions in *Governor-General in Council v. Shiromani Sugar Mills Ltd.* [1946] 14 ITR 248 : 16 Comp. Cas. 71 ; AIR 1946 16 (Federal Court) . and *Official Liquidator, High Court,*

Official Liquidator, High Court, Calcutta Vs. Commissioner of Income Tax, West Bengal,

12. I have gone through Section 178 of the Income Tax Act, which is the centre of controversy in this case, but it does not also govern or affect the rule of priority contained in Section 530 of the Act. The same view has been taken in Income Tax Officer, Company Circle, Bangalore Vs. Official Liquidator, Mysore High Court and Others, . Even so, the Income Tax Officer had issued the notice (Annexure " I ") to the liquidator u/s 178 of the Income Tax Act requiring him to set aside an amount of Rs. 41,00,000 exclusively for the payment of Income Tax which, according to him, was payable or was likely to be payable by the company. It is not disputed before me that not even a fraction of the amount claimed as Income Tax can be classified as a preferential debt u/s 537 as no part of it became due and payable within the period of twelve months next before the date (December 5, 1967) of appointment of the provisional liquidator, and, in issuing the notice, the Income Tax Officer has, therefore, appropriated to himself the power of converting an ordinary debt into a preferential debt under cover of Section 178 of the Income Tax Act.

13. As it is, there is nothing in Section 178 to justify such a conversion, for the section reads as follows :

" 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 enquiries 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 amounts, 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. "

14. On the other hand, a perusal of Section 446(2)(d) of the Act shows that the court which is winding up the company shall " notwithstanding anything contained in any other law for the time being in force, have jurisdiction to entertain, or dispose of (d) any question of priorities ". And it has been laid down by their Lordships of the Supreme Court in *Damji Valji Shah and Another Vs. Life Insurance Corporation of India and Others*, that this jurisdiction vests "exclusively" in the company court. It is not, therefore, permissible for the Income Tax Officer to encroach on that jurisdiction in the guise of a notice u/s 178.

15. Mr. Sharma has, however, strenuously argued that Section 178 has been incorporated in the present Income Tax Act, and Sub-sections (3) and (4) have been substituted for the earlier sub-sections, for the purpose of engrafting a special provision for securing and ensuring easy recovery of Income Tax in " preference " to all other debts owed by the company, and that the proviso to Sub-section (3) now provides for the recovery of Income Tax by stating that nothing in the sub-section shall debar the liquidator from parting with the assets or properties of the company for the purpose of payment of the Income Tax on the same footing as payment to secured creditors. The learned counsel has made a reference to Sub-section (6) for the argument that the provisions of Section 178 shall override the provisions of the Companies Act in this respect. He has also argued, on the strength of *Income Tax Officer, Ernakulam v. Indian Traders Bank (in liquidation)* [1968] 2 Comp. L.J. 342. that Section 178 creates a first charge

on the amount set aside under Sub-section (3) thereof for payment of the amount of tax admitted to proof.

16. I have no doubt, however, that there is no force in this argument because there is nothing in any part of Section 178 which could be said to support it. But, even if it is assumed, for the sake of argument, that Section 178 creates any such super-priority or preference in respect of the Income Tax payable by a company in liquidation, even then, being a "question of priorities" within the meaning of Section 446(2)(d) of the Act, it must fall within the "exclusive" jurisdiction of the company court referred to in the decision of their Lordships of the Supreme Court in *Damji Valji Shah and Another Vs. Life Insurance Corporation of India and Others*, to which reference has been made already.

17. I have examined the scope of Sub-section (6) of Section 178 of the Income Tax Act, but I do not find any justification for the argument of the learned counsel for the respondent that it should prevail because it is "contrary" to Section 446(1) of the Act. As far as I can see, there is nothing in Section 178 to take it out of the purview of Section 446 for there is no reason why, before taking the legal proceeding u/s 178 of the Income Tax Act, the Income Tax Officer should not obtain the leave of the court u/s 446(1) of the Act.

18. This leaves for consideration the argument of Mr. Sharma that a notice u/s 178 of the Income Tax Act is nothing more than a garnishee order and that it should not, therefore, attract the application of Section 446(1) of the Act. The argument is futile because all that a garnishee order does is to make the judgment-creditor his own sheriff in fact. He puts in his own execution, and the service of the order virtually amounts to taking possession of the property. It is, therefore, a mode of execution and will attract the control of the court all the same.

19. It follows, therefore, that, in any view of the matter, it was not permissible for the Income Tax Officer to reach and freeze the assets and the properties of the company, for the purpose of realising the income tax after its quantification, without the leave of the court u/s 446(1) of the Act, or to assume the power of deciding the question of preferential payment. The grant of leave u/s 446(1) is not an empty formality, for the court can, at any rate, make the provisions of Section 178 of the Income Tax Act workable by imposing some such "term" in granting the leave, as would make the demand (under the notice) to conform to the requirement of the law and to safeguard its payment to the extent permissible under the law and the resources of the company.

20. But, as this has not been done, and as the impugned notice (annexure "I") has been issued without obtaining the leave of the court u/s 446, and as it is quite clear from the reply of the respondent that it has been issued in violation of the provisions of Section 530 of the Act, and as this has made it impossible to proceed with the winding up of the company according to the law, it must be held that the notice is invalid and that the liquidator is not required to comply

with it. It is ordered accordingly. The applicant will be entitled to costs from the respondents.