

(1997) 12 BOM CK 0024

In the Bombay High Court

Case No : Company Petition No. 44 of 1986

Polyolefins Industries Ltd.

APPELLANT

Vs

Kosmek Plastics Manufacturing Co. Ltd.

RESPONDENT

Date of Decision : 19-12-1997

Acts Referred:

Companies Act, 1956 — Section 476, 520, 529, 529A, 530

Income Tax Act, 1961 — Section 178, 178(1), 178(2), 178(3), 220

Citation : (1998) 2 ALLMR 277 : (1999) 98 CompCas 481 : (2000) 242 ITR 269

Hon'ble Judges : A.P. Shah, J

Bench : Single Bench

Advocate : K.B. Bhujle, T.U. Khatri, for the Appellant; P.S. Gajwani, for the Respondent

Judgement

A.P. Shah, J.—The short question which falls for consideration is whether the capital gains tax arising out of the sale of the assets of the company in liquidation by the official liquidator can be satisfied from out of the proceeds of the sale of the company's assets either as "costs, charges and expenses incurred in the winding up" under sections 476 and 520 of the Companies Act, 1956, or as an amount set aside u/s 178 of the Income Tax Act in priority to the workmen's claim under sections 529 and 529A of the Companies Act.

2. The company, M/s. Kosmek Plastic Manufacturing Company Limited (in liquidation), was ordered to be wound up by this court on July 22, 23, 1987. During the course of liquidation the assets of the company were sold by the liquidator and the liquidator is having a sum of Rs. 58,47,642 to its credit. The liquidator has received in all 233 claims from the workers amounting to Rs. 1,02,20,324, and unsecured claims to the extent of Rs. 76,449. The sale of the company's assets has resulted in capital gains within the meaning of that expression in the Income Tax Act. The liquidator has made a report dated February 28, 1996, submitting that in view of section 529 read with section 529A the claim of the workers shall be a secured one and will be in preference to other

preferential claims including the claim of the Income Tax Department for capital gains tax. The Income Tax Department has filed an affidavit opposing the report, inter alia, on the ground that the Department's claim for capital gains tax shall have precedence over the claim of the workers. The claim of the Department is based firstly on section 178 of the Income Tax Act and in the alternative u/s 476 read with section 520 of the Companies Act.

3. By Amending Act No. 35 of 1985, Parliament had brought about important and significant changes in the provisions of the Companies Act. By virtue of sections 529, 529A and 530, substantial rights and benefits are conferred on the workmen of the closed undertaking, the workmen getting rights *pari passu* with those of the secured creditors over the assets of the company in liquidation. A perusal of section 530 makes it clear that (i) this provision is subject to the provisions of section 529A of the Companies Act, and (ii) the revenues, taxes, cess and rates must have become due and payable within the 12 months next before the relevant date which is the date of appointment of the provisional liquidator or the date of winding up, as the case may be, in order that they may be paid in priority to other debts. 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. The object of section 529A is to ensure that the workmen are not deprived of their legitimate claims in the event of the liquidation of a company. By this provision, the workmen's dues and the secured creditors' 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 creditors 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".

4. It is common ground that there are no secured creditors of the company. The workers' claim is more than a crore of rupees whereas the amount realised by auction of the assets of the company is around Rs. 53,00,000. The company is apparently insolvent. Now the question to be decided is whether the Income Tax Department will have precedence over the workers' claim in respect of the capital gains tax arising upon the sale of the assets of the company in the liquidation proceedings. The preferential claim made by the Income Tax Department will not come under either section 178 of the Income Tax Act, or section 530(1)(a) of the Companies Act. Section 173(1) of the Income Tax Act provides for giving notice of appointment of a liquidator of a company on its winding up to the Income Tax Officer who is entitled to assess the income of the company. The notice has to be served within 30 days of the appointment. On receipt of such a notice 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 the 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 likely thereafter to become payable by the company. On being so notified the liquidator shall set apart an amount equal to the amount notified. The failure to give notice in accordance with the provisions of the section or the failure to set apart the amount as required by the Income Tax Officer or parting with the assets of the company otherwise than as provided for in sub-section (3) of section 178 makes the liquidator personally liable for the payment of the tax which the company is liable to pay. This provision shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force in this case, it is not the case of the Income Tax Department that the liquidator did not notify the fact of his appointment to the Income Tax Officer. It is also not disputed that the Income Tax Officer did notify him within the period mentioned in sub-section (2) of section 178 to set apart any amount for tax payment. Further, the tax payment referred to in that section is in respect of the income of a company accrued before its winding up. It has no application to the income accruing to the company after the order for its winding up. In view of this clear legal position, Mr. Khatri, learned counsel appearing for the Department has not pressed the claim u/s 178(l) of the Income Tax Act. Equally, this claim will not come u/s 530(l)(a) of the Companies Act, for this tax liability did not become due and payable within twelve months next before the winding up date.

5. This takes us to the second point urged on behalf of the Income Tax Department, namely, that this tax demand is by way of costs, charges and expenses incurred in the winding up and under the principle stated in section 520 of the Act and section 476 this amount is payable before the assets are distributed to the unsecured creditors. Mr. Khatri urged that capital gains tax is an item of expenditure incurred for realising the assets of the company and, therefore, payable before other debts. According to Mr. Khatri, the expression "costs, charges and expenses" referred to in sections 520 and 476 of the Companies Act is extremely wide. In this will come the cost of repairs, payment of rent and tax, cost of preservation of any property, cost of realisation, etc. Mr. Khatri submitted that the Income Tax which became payable at the winding up also is an expense in the winding up. Income Tax is a necessary consequence of the acts performed by the liquidator in the course of the liquidation for the purpose of realising, as it was his duty to do, the assets of the company. Mr. Khatri invited my attention to the decision of the Chancery Division in *Beni Felkai Mining Co., In re* [1934] 2 ITR 309. At page 314, justice Maugham observed as follows :

"I have a difficulty in seeing how a liquidator who, in the course of his liquidation, carries on the business of the company at a profit, the consequence being the assessment of the company to Income Tax, can avoid the conclusion that this is one of the expenses in the winding up. It is curious that in the authorities to which I have referred the phrase does not seem to have been used by the court.

In my opinion, rates and taxes - and for the purpose I can group them together, although there is for some purposes a distinction between them-falling due subsequently to the winding up are part of the expenses of the winding up."

6. Again, at page 315, the learned judge further observed as follows :

"I do not see any particular reason for limiting the meaning of the phrase "expenses of the liquidation", or "expenses incurred in the winding up". The term is not one of art, and I see no reason why it should not include any expenses which the liquidator might be compelled to pay in respect of his act in the course of a proper liquidation of the company's assets. In my opinion, then, the sums in question are sums which can be properly treated as expenses in the liquidation."

7. Placing strong reliance on the above observations, Mr. Khatri submitted that the capital gains tax falling due subsequently to the winding up is part of the expense of the winding up. Mr. Khatri also brought to my notice a decision of the Kerala High Court in ITO v. Official Liquidator, Swaraj Motors (P.) Ltd. [1978] 48 Comp Cas 11; [1977] Tax LR 1816. In that case, the Division Bench of the Kerala High Court following the decision in Beni Felkai Mining Co., In re [1934] 4 Comp Cas 293 held that rates And taxes falling due subsequent to the winding up are part of the expenses of the winding up and Income Tax is a necessary consequence of the acts performed by the liquidator in the course of the liquidation for the purpose of realising the assets of the company. Under sections 520 and 476, the court can direct the liquidator to pay the demand of the Income Tax Officer before distributing the dividend. Accordingly, the Kerala High Court directed the liquidator to pay the balance Of the Income Tax demand to the Income Tax Officer.

8. I am unable to accept the submission of Mr. Khatri based on sections 520 and 476 of the Companies Act. Mr. Bhujle, learned counsel appearing for the official liquidator pointed out that from the facts of the case relied upon by Mr. Khatri, 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. Mr. Bhujle rightly pointed out that by virtue of section 529A read with section 529, the workers are placed in the position of secured creditors. He pointed out that the provisions of section 520 clearly say that the claim of secured creditors cannot be overridden by section 520. The word "assets" can only mean the fund available as assets, after the claims of secured creditors are paid off. In this connection, he brought to my notice a decision in Raja Bahadur Motilal Shivilal Vs. The Poona Cotton and Silk Mfg. Co. Ltd., . In the said case this court considered the claim of a 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 "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 of [1917] ILR 42 220; page 247 of 41 IC 246) :

"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 the 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 payments 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' cost, all of which have priority over the general costs of the liquidation and the costs of carrying on the business of the company."

9. The above judgment was confirmed by the appellate judgment of Raja Bahadur Motilal Shivilal Vs. The Poona Cotton and Silk Mfg. Co. Ltd., . In my opinion, Mr. Bhujle is right in contending that section 520 cannot override the rights of the secured creditors. The section does not give priority over the mortgagees and other secured creditors on the assets on the commencement of the winding up except to the extent of the costs of liquidation being the costs of preservation or realisation beneficial to the security holders. (See Regent's Canal Ironworks Co., In re [1876] 3 LR 43 (Ch. D). Thus, reliance placed by the Department on sections 520 and 476 for claiming priority over the workers' dues is clearly misconceived.

10. It is also required to be noted that section 529A is a subsequent provision. It contains a non-obstante clause. Therefore, to my mind the provisions of section 529A would override the provisions contained in sections 520 and 476 of the Companies Act. It is a well established principle of law that if there is an apparent conflict between two such provisions of law, the special provision must prevail See Union of India (UOI) and Another Vs. India Fisheries (P) Ltd., . I am fully supported in my view by the judgment of the Kerala High Court in Giovanola Binny Ltd, (In Liquidation), In re [1990] 67 Comp Cas 441. The learned single judge of that court has held that the Income Tax Department will have no priority over the workers' claim under sections 529 and 529A of the Act.

11. In view of the foregoing discussion, prayers (a) to (e) of the liquidator's report are granted.

12. On the request made by Mr. Khatri, the operation of this order is stayed for a period of six weeks.

13. Order accordingly.