
(2004) 11 KL CK 0063

In the High Court Of Kerala

Case No : O.P. No. 8845 of 2001, W.P. No's. 26523 and 27302 of 2003 and W.A. No's. 1165 and 1232 of 2003

Sherry Jacob

APPELLANT

Vs

Canara Bank

RESPONDENT

Date of Decision : 10-11-2004

Acts Referred:

Kerala General Sales Tax Act, 1963 — Section 26B

Citation : AIR 2005 Ker 50 : (2004) 3 KLT 1089

Hon'ble Judges : N.K. Sodhi, C.J;A.K. Basheer, J

Bench : Division Bench

Advocate : Kurian George Kannamthanam, for the Appellant; Raju Joseph, Government Pleader, C.B. Sreekumar, A.C.G.S.C., P.B. Suresh Kumar, K. Moni, T.G. Rajendran, N.N. Sugunapalan, V.P. Seemanthini, P.S. Divakaran and Veena B. Kumar, for the Respondent

Judgement

A.K. Basheer, J.—This bunch of 5 cases - 2 Writ Appeals and 3 Original Petitions - has thrown up an important question for our consideration. Since the parties and issues involved are the same, we are disposing of these cases by this common judgment.

2. Can the State claim precedence or primacy for its debts over the claims of a secured creditor? To be a little more specific -- Can the State enforce a statutory first charge on the property of a debtor, in preference to an existing mortgage in favour of a secured creditor?

3. A brief reference to some of the essential facts is necessary to answer the above question.

4. M/s. Thomas Stephen & Company, Kollam (hereinafter referred to as "the Company") which was engaged in a manufacture and sale of roofing tiles, bricks etc. had availed of various loans from Canara Bank at Thamarakkulam (for short, "the Bank"). The company had furnished sufficient security for repayment of the debt, in addition to creating mortgage by deposit of title deeds of certain items of

immovable property as a continuing collateral security. The mortgage was created, initially, on July 9, 1974 which was renewed from time to time. Since the Company defaulted in repayment of the loan, the Bank instituted a suit for recovery of money before the Subordinate Judge's Court, Kollam. Later the suit was transferred to the Debt Recovery Tribunal at Ernakulam (for short, "the Tribunal"). By judgment dated February 17, 2000, the Tribunal directed the company to pay the plaintiff/Bank a sum of Rs. 41,25, 451.64 together with interest at the rate of 15% per annum from August 24, 1992. It was held that the plaintiff/Bank was entitled to realise the decree debt by sale of the mortgaged/hypothecated properties.

5. On October, 4, 2002 the Recovery Officer of the Tribunal issued a proclamation for sale of two items of the mortgaged properties in execution of the decree in favour of the Bank. The sale was held on January 31, 2003. One Ahammed Koya (hereinafter referred to as the auction purchaser) was the successful bidder in respect of item No. 1. The bid amount of Rs. 60,60,010/- offered by the auction purchaser for the above property having an extent of 40 cents with buildings therein was accepted. The Recovery Officer issued a certificate of sale and an order of confirmation in favour of the auction purchaser on June 19, 2003. According to the auction purchaser, he was put in "actual physical possession" of only 31.50 cents of land along with the building therein on June 30, 2003. The remaining 8.50 cents and the building therein were not delivered to him on that day, since one Sri. Sherry Jacob (the licensee for short) was stated to be in occupation of the said land and building on the strength of an agreement for sale between him and the Company.

6. But it appears that long prior to the sale mentioned above, the Tahsildar (Revenue Recovery), Kollam had issued a notice on July 18, 2000 u/s 36 of the Kerala Revenue Recovery Act, 1890 (for short, "the R.R. Act"), attaching the said property belonging to the Company. This order of attachment was issued since the Company had allegedly committed default in payment of sales tax arrears to the tune of Rs. 3, 04, 577/- for the assessment years 1974-75 to 1997-98. Subsequently on February, 13, 2001, the Tahsildar issued a notice u/s 49(2) of the RR Act for sale of the above immovable property belonging to the Company to recover a total sum of Rs. 8,13,381/-. The sale was scheduled to be held on March 17, 2001.

7. It was at this juncture that the Bank filed the present Original Petition viz., O.P. No. 8845/2001 praying for issuance of a writ of certiorari to quash the sale notice issued by the Tahsildar under the R.R. Act. A learned Single Judge before whom this Original Petition came up for consideration issued an order of interim stay of all further proceedings pursuant to the sale notice. The above order was passed by the learned Single Judge on March 15, 2001. The said order is still in force.

8. But, as mentioned earlier, the Recovery Officer of the Tribunal had conducted sale of the attached property on January 31, 2003. The State Government

through the District Collector, Kollam and the Tahsildar (R.R.) Kollam have therefore filed W.P.No.26523/2003 with a prayer to quash "the entire sale proceedings" conducted by the Recovery Officer of the Tribunal. There is a further prayer for a direction to the auction purchaser to hand over possession of the property to the Revenue Officers to enable them to conduct "fresh sale for realisation of arrears".

9. The third Writ Petition viz., W.P.No.27302/2003 has been filed by the auction purchaser. The prayer in the Writ Petition is to issue a Writ of mandamus to the Revenue Officers and also the Regional Provident Fund organisation not to proceed against the property purchased by the auction purchaser in the auction held by the Recovery Officer of the Tribunal and also to release the property from attachment, if any, effected by the said authorities. There is a further prayer for a declaration that the property purchased by him in the auction is not liable to be proceeded against for recovery of either arrears of sales tax or towards dues payable under the Employees Provident Fund and Miscellaneous Provisions Act.

10. W.A. Nos. 1165/2003 and 1232/2003 are filed by the Company and the licensee respectively against a common judgment passed by the learned Single Judge dismissing the two Original Petitions filed by them challenging the sale conducted by the Recovery Officer of the Tribunal.

11. The above three Writ Petitions filed by the Bank, the State and the auction purchaser have come up before us, on a reference made by a learned Single Judge, to be heard along with the two Writ Appeals, "since the issues involved in these cases are closely connected and related to the same property".

12. Sri. P.B. Suresh Kumar, learned counsel for the Bank submits that the sale conducted by the Recovery Officer of the Tribunal cannot be set at naught at the instance of the State on the ground that the property had been attached for recovery of arrears of sales tax. The Tribunal constituted under the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (for short "the RDB Act") had passed the decree in favour of the Bank after hearing the judgment debtor. The plaintiff/Bank was found entitled to realise the decree debt by sale of the mortgaged properties. A certificate of recovery was issued by the Tribunal and the Recovery Officer had brought the property to sale. The sale was held on January 31, 2003 as provided under the Act and the Rules. The property which was sold by the Recovery Officer was mortgaged to the Bank on July 9, 1974. The decree enabled the Bank to bring the mortgaged property to sale. Even assuming the State was entitled to recover any arrears of sales tax from the Company by proceeding against the mortgaged property, such recovery can be effected only if any amount is left over after due satisfaction of the decree in favour of the Bank. Since the Bank had a pre-existing mortgage right over the property and since a decree was passed by the Tribunal even prior to the date of attachment by the State under the RR Act, the challenge made by the State to the sale by the Recovery Officer is wholly untenable.

13. But Sri.Raju Joseph, learned Senior Special Government Pleader (Taxes) contends that in view of the statutory first charge created in favour of the State by virtue of the provisions contained in Section 26-B of the Kerala General Sales Tax Act (the KGST Act, for short), neither the Bank nor the auction purchaser can be heard to say that the right of the mortgagee (Bank) is indefeasible or unimpeachable. State has got priority in respect of its debts against the claim of even a secured creditor. This preferential right available to a Crown debt is well recognised. More importantly Section 26-B of the KGST Act further creates a statutory first charge in favour of the State on the property of the dealer if he commits default in payment of sales tax, penalty etc.

14. The doctrine of "Priority of Crown debts" has been the subject of a catena of judicial pronouncements of the Apex Court and various High Courts. The preferential right of the Crown in the matter of recovery of debts over other creditors subject to certain conditions is well settled. In Builders Supply Corporation Vs. The Union of India (UOI) Represented by the Commissioner of Income Tax, West Bengal and Others, , a Constitution Bench of the Apex Court had noticed a consensus of judicial opinion that the arrears of tax due to the State can claim priority over private debts.

15. The following observation of their Lordships of the Supreme Court in Dena Bank Vs. Bhikhabhai Prabhudas Parekh and Co. and Others, , is apposite:

"The principle of priority of Government debts is founded on the rule of necessity and of public policy. The basic justification for the claim for priority of State debts rests on the well recognised principle that the State is entitled to raise money by taxation because unless adequate revenue is received by the State, it would not be able to function as a sovereign Government at all. It is essential that as a sovereign, the State should be able to discharge its primary governmental functions and in order to be able to discharge such functions efficiently, it must be in possession of necessary funds and this consideration emphasises the necessity and the wisdom of conceding to the State, the right to claim priority in respect of its tax dues....."

16. In Bhikhabhai's case (supra) the question was whether the State of Karnataka could raise a preferential claim over the properties which were mortgaged in favour of Dena Bank. The above claim was raised by the State of Karnataka in the suit filed by Dena Bank against its debtors. The Trial Court negated the claim of the State and held that the Bank was entitled to get a decree on the strength of the mortgage created in its favour. During the pendency of the appeal before the High Court of Karnataka, the matter was settled between the plaintiff/Bank and the defendants on certain terms and conditions stipulated in the compromise petition. But the State of Karnataka which was not a party to the compromise contended that the compromise was not binding on the State as it would defeat its preferential right. After hearing the parties and on a consideration of the terms of compromise, the High Court held that the sales tax arrears recoverable by the State from the defendants had

priority over the plaintiff's claim. In the appeal filed by Dena Bank before the Supreme Court, it was contended that the right of preference or precedence given to the State of Karnataka over the right of the Bank to proceed against the mortgaged property was not legally sustainable. But the Supreme Court repelled the contentions of the appellant Bank after referring to Section 158 and other relevant provisions of the Karnataka Land Revenue Act, 1964. It was noticed by the Supreme Court that Sub-section (1) of Section 158. of the Karnataka Act gave "statutory recognition to the doctrine of the State's priority for recovery of debts". It was also noticed by their Lordships that the above sub- section gave precedence to the claim of the State Government to recover any money payable under the provisions of the Act. "Over any other debt, demand or claim whatsoever whether in respect of mortgage, judgment decree of execution or attachment or otherwise howsoever against any land or the holder thereof.

17. It is submitted by Sri. Raju Joseph, the learned Government Pleader, that the Company which was an assessee under the KGST Act had failed to remit the sales tax, penalty etc. for the assessment year 1974-75 and thereafter; Though notices of demand were issued to the Company on several occasions, the tax arrears were never paid. In March 1978 the Government had granted stay of all revenue recovery proceedings on condition that the Company furnished security for the amount in arrears. Pursuant to the above order of the Government, the Company had executed a security bond on June 26, 1978 by which they gave the movable and immovable assets of the Company as security. In July 2000 revenue recovery proceedings were again initiated. Ext.P4 notice u/s 34 of the RR Act was issued and subsequently the property of the Company was put under attachment. It was thereafter that in February 2001 sale notice u/s 49(2) of the R.R. Act was published for sale" of the immovable property of the Company. It is the admitted position that the Recovery Officer of the Tribunal had sold the property in auction when the property was under revenue attachment and also after a notice of sale was issued by the revenue authorities. Therefore the contention of the Revenue is that the sale by the Recovery Officer is totally illegal and vitiated especially since Section 26B.of the KGST Act creates a first charge on the property of the defaulting dealer.

18. In this context it is necessary to refer to Section 26-B of the KGST Act which reads thus:

"26-B. Tax payable to the first charge on the property:-Notwithstanding anything to the contrary contained in any other law for the time being in force, any amount of tax, penalty, interest and any other amount, if any, payable by a dealer or any other person under this Act, shall be the first charge on the property of the dealer, or such person".

19. A perusal of the above statutory clause unambiguously shows that any amount of tax, penalty etc. payable by a dealer "shall be the first charge on the property of the dealer or such person". Section 26-B starts with a non-obstante clause, which necessarily gives it an overriding effect to any other law in force. It

creates a first charge on the property of the dealer in no uncertain terms. But does this statutory first charge have an overriding effect on the pre-existing mortgage right of a secured creditor? Can the State take the plea that the "statutory first charge" operates on the entire property under mortgage and not only on the right of equity of redemption available to the mortgagor/dealer?

20. Two identical statutory provisions contained in the Sales Tax Acts of the State of Rajasthan and the State of Madhya Pradesh which are in part materia to Section 26-B of the KGST Act had come up before the Supreme Court for consideration in almost similar situations. In *State Bank of Bikaner and Jaipur Vs. National Iron and Steel Rolling Corporation and Others*, , the question was whether the statutory first charge in Section 11 AAAA in the Rajasthan Sales Tax Act, 1954 could have precedence over an existing mortgage. In a suit filed by the State Bank of Bikaner and Jaipur against the defendant for recovery of certain amounts advanced by it to the defendants on the strength of mortgage created in its favour, the Commercial Tax Officer got himself impleaded on the ground that he had a prior claim for recovery of more than Rs. one lakh as sales tax due from the defendant and therefore he was entitled to realise it by sale of the mortgaged property. The claim of the Commercial Taxes Officer was accepted by the Trial Court and it was affirmed in revision by the High Court. After considering the provisions contained in S 11- AAAA of the Rajasthan Act, the Supreme Court held that the statutory first charge created by the above provision operates on the entire property of the dealer including the interest of the mortgagee therein. The contention that the first charge would operate only over the equity of redemption was rejected by the Supreme Court. A perusal of the above provision is Section 11-AAAA introduced by an amendment in 1989 in the Rajasthan Act shows that the said provision is exactly identical to Section 26B of the KGST Act but for a slight change in the title of the section.

21. In *State of Madhya Pradesh and Anr. v. State Bank of Indore and Ors.* (2002) 10 KTR 366 (SC) Section 33-C of the Madhya Pradesh General Sales Tax Act, 1958 was considered. Incidentally, Section 33-C of the M.P. Act is also identical to Section 26-B of the KGST-Act. In this case also their Lordships held that the statutory first charge prevails over any other charge including mortgage. The dictum laid down in *Bhikhabhai's* case (supra) was followed by their Lordships in this case.

22. In view of the above two decisions of the Supreme Court in *State Bank of Bikaner* and *State Bank of Indore* (supra) which had dealt with two exactly identical statutory provisions as contained in Section 26-B of the KGST Act, we have no hesitation to hold that the statutory first charge will prevail over any charge or right created in favour of a mortgagee/secured creditor. The statutory first charge gets precedence over an existing mortgage right. The precedence or priority is not confined to right of redemption alone. In this context the observations of their Lordships of the Supreme Court in *State Bank of Bikaneri* case (supra) may also be noticed:

"Where a mortgage is created in respect of any property, undoubtedly an interest in the property is carved out in favour of the mortgagee. The mortgagor is entitled to redeem his property on payment of the mortgage dues. This does not, however, mean that the property ceases to be the property of the mortgagor. The title to the property remains with the mortgagor. Therefore a statutory first charge is created on the property of the dealer. The property subjected to the first charge is the entire property of the dealer. Interest of the mortgagee is not excluded from the first charge.

23. Sri.Suresh Kumar, learned counsel for the Bank has raised yet another contention. According to the learned counsel, Section 26-B was introduced only with effect from April 1, 1999. There is no indication that the above provision would have retrospective operation. Its operation can only be prospective. The contention is that since the mortgage in favour of the Bank was pre-existing as on the date of introduction of Section 26-B in the KGST Act, the pre-existing right of the Bank would not be affected.

24. It is pertinent to note that an identical contention was raised in Bhikhabhai's case and in State Bank of Bikaner's case (supra). The said contention was repelled by the Supreme Court in both the cases. The principle laid down by their Lordships in the two decisions would squarely apply in this case also. It may be noted that as on the date of introduction of Section 26-B of the KGST Act, the right of the Bank based on the mortgage had not crystallised into a decree. The Tribunal had passed the decree only in the year 2000. But Section 26-B was introduced in April 1999. The sale of the mortgaged property was held in the year 2003. It is true that the mortgage was created in favour of the Bank in the year 1979. But significantly, the liability of tax had arisen in the year 1974-75, long prior to the creation of the mortgage in favour of the Bank. Thus, in our view, the contention raised by the learned counsel cannot be sustained for the above reasons also.

25. The other contention raised by the learned counsel is based on Section 100 of the Transfer of Property Act. It is urged by the learned counsel that the charge created u/s 100 at the time of creation of the mortgage cannot be defeated by a statutory charge which came into operation at a later stage. This contention has also been answered by their Lordships in Bhikhabhai's case and the answer is against the petitioner.

26. In view of the above legal position, it has to be held that the right, if any, of the Recovery Officer to conduct sale of the mortgaged property in question was only subject to the statutory first charge available in favour of the State to recover the sales tax arrears from the Company. The admitted position is that the revenue authorities had effected attachment of the property even prior to the sale conducted by the Recovery Officer. Though a sale notice was published by the Revenue Officers, the sale did not take place. This sale notice was also long prior to the sale conducted by the Recovery Officer. Thus in any view of the matter, the sale conducted by the Recovery Officer without notice to the Revenue

is liable to be set aside.

27. The next question that arises for consideration is whether the State can be allowed to conduct a revenue sale for recovery of its alleged arrears. It is pertinent to note that in the sale notice the Tahsildar (RR) had quantified the amount recoverable from the Company as Rs. 8,13,381/-. The learned Special Government Pleader for Taxes has, however, contended before us that the total amount due from the Company is much more than that and it may come to nearly Rs. 33 lakhs. But learned counsel for the Bank and the auction purchaser submit that the State cannot be permitted to go beyond the sale notice. If the State has to recover more money, fresh steps will have to be initiated as provided under the Revenue Recovery Act. We find considerable force in the above contention. The grievance of the State was that despite the sale notice published by its officers, the recovery officer had proceeded to sell the property ignoring the earlier attachment. If that be so, the State has to necessarily exercise its right of sale with reference to the sale notice issued by it in February 2003. But at the same time, it will be always open to the Revenue to initiate fresh steps for sale to recover the entire balance due.

28. As regards the claim of the auction purchaser, it has to be held that his right can only be subject to the validity of the sale held by the Recovery Officer. We have already found that the sale conducted by the Recovery Officer was not legally valid.

29. As regards the two Writ Appeals filed by the Company and the licensee are concerned, we have no hesitation to hold that these two appeals are without any merit. As far as W.A.I 165/2003 filed by the Company is concerned, the appellant cannot be heard to say that the sale by the Recovery Officer was not proper or valid. Admittedly the decree passed by the Tribunal against the company had become final. The sale was conducted on the strength of a certificate of recovery issued by the Tribunal after hearing the Company/judgment debtor. In our view, the learned Single Judge was right in repelling the-contentions raised by the Company against the sale.

30. There is yet another aspect of the matter. The Company is now in liquidation. The Company Court had passed orders of winding up. The Official Liquidator is in charge of the affairs of the Company. In fact, the Official Liquidator had addressed this Court on behalf of the Company, as he had got himself impleaded in the case. It was submitted that the Official Liquidator will await the orders of the Company Court in the matter of discharge of the liabilities of the Company.

31. W. A. 1232/2003 filed by the licensee is also without any merit. Though it was contended by the licensee that the Company had agreed to sell 8.5 cents in item No. I of the mortgaged property, there is nothing on record to substantiate the above contention. It is admitted by the licensee himself that there is a clear recital in Ext. PI agreement for sale that the said transaction will always be subject to mortgage in favour of the Bank. It is also the admitted position that

there is a further recital in the agreement that the property which was agreed to be sold was subject to a mortgage in favour of the Bank and that the matter was pending in litigation. In that view of the matter the licensee is not entitled to claim that the Company is bound to assign the property to him by virtue of the agreement for sale. It may be true that he has been in possession of 8.5 cents and the building therein. But his occupation is only permissive and he can continue in occupation till the licence to occupy is revoked.

In the result W.A. Nos. 1165/2003 and 1232/2003 are dismissed. Similarly O.P.8845/2001 and W.P.(C). 27302/2003 are also dismissed.

W.P. 26523/2003 is allowed.

The sale conducted by the Recovery Officer of the Tribunal is set aside.. The revenue authorities shall be at liberty to proceed against the property of the Company under the RR Act and on the strength of the first charge created over the property by virtue of S .26-B of the KGST Act. The auction purchaser shall be entitled to approach the Tribunal for refund of the purchase money deposited by him pursuant to the sale held by the Recovery Officer.

The parties are directed to suffer their respective costs in all the above cases.