

(1999) 02 BOM CK 0094

In the Bombay High Court

Case No : Company Application No. 116 of 1998 in Company Petition No. 459 of 1989 Alongwith Company Application No. 117 of 1998 in Company Petition No. 459 of 1989

Syndicate Bank and another

APPELLANT

Vs

The Official Liquidator and others

RESPONDENT

Date of Decision : 05-02-1999

Acts Referred:

Companies Act, 1956 — Section 529
Constitution of India, 1950 — Article 372(1)
Income Tax Act, 1961 — Section 178

Citation : AIR 1999 Bom 243 : (1999) 2 BomCR 618 : (1999) 98 CompCas 487 : (2000) 242 ITR 281 : (1999) 2 MhLj 338

Hon'ble Judges : F.I. Rebello, J

Bench : Single Bench

Advocate : Virag Tulzapurkar, instructed by Kanga and Co, for the Appellant;
S.C. Gupta, for the Respondent

Judgement

F. I. Rebello, J.—These applications arise from the order of winding up of Wester Works Engineers Limited. As the applicants have prayed for similar reliefs and as the same questions of law arise in the matter, they are being disposed of by this common order.

2. The applicants in Company application No. 116 of 1998 have prayed that the respondent No. 1 be ordered and directed to pay to the applicants a sum of Rs. 19, 48, 552/- together with interest thereon at the rate of 19.13% per annum from 27th November, 1997 till payment and/or realisation. The expenses were incurred by the applicants towards sale of securities given by Company in liquidation pursuant to the order passed by Board of Industrial and Financial Reconstruction. A further direction which is sought is, that a sum of Rs. 7,76,75,000/- being approximately 75% of the amount due and payable by the Company in liquidation to the applicants be paid to them.

Similarly, in Company Application No. 117 of 1998 the Applicants have prayed

that the 1st respondent be ordered and directed to pay a sum of Rs. 6,65,00,000/- being approximately 75% of the amount due and payable by the Company in liquidation to the applicants.

3. On behalf of the Official Liquidator it is pointed out that the sum of Rs. 22,24,38,315/- excluding an amount of Rs. 50,57,080/- towards T.D.S. has been deposited with the Official Liquidator on 3rd November, 1997. An affidavit in reply has been filed by Shri Ujjwal Roy, Official Liquidator to meet the contentions as raised in the application. It is therein set out that an amount of Rs. 22,24,00,000/- has been invested in Fixed Deposits with various banks, out of the sum of Rs. 22,24,38,318/- alongwith interest to his credit as on 10th December, 1998. It is thereafter set out that the claims received by his office are Rs. 73,33,10,668.34 Ps. which includes claims by workers and employees amounting to Rs. 41,89,68,067.38. The claims of Syndicate Bank and Oriental Bank of Commerce works out to Rs. 21 lakhs and odd. There is also a claim in an amount of Rs. 6,13,50,193/- being claim of Income Tax Department and Rs. 58,93,163/- being the claim of Sales Tax Department. The claims of the Income Tax were received pursuant to letter dated 18th November, 1996 of the Dy. Commissioner of Income Tax and of the Sales Tax on receipt of copy of the Form No. 66 dated 13th December, 1996. The applicant Banks were secured creditors in respect of the property situated at Bhandup from which an amount of Rs. 14.5 crores were realised as sale proceeds. The applicants are not secured creditors in respect of other properties which have been sold. The Official Liquidator out of the said sum of Rs. 14.5 crores has to set aside the sum of Rs. 6,13,50,193/- towards Income Tax dues and a sum of Rs. 12,12,901/- towards Sales Tax dues. After deducting these amounts it is claimed only an amount of Rs. 8,24,36,906/- will be available subject to other deductions.

On behalf of the applicant it is contented that they are secured creditors in respect of the proceeds arising from sale of Bhandup property and as such the amount which the Official Liquidator purports to pay towards Income Tax and Sales Tax demand cannot have preference over the claims of secured creditors.

4. The question therefore is, whether the tax liabilities like Income Tax or Sales Tax have preference over the rights of the secured creditors and workers in so far as the sale proceeds of Bhandup property are concerned. Learned Counsel for the applicant Banks contend that the claims of secured creditors are outside the winding up proceedings and consequently there can be no preferential right by Income Tax Authorities u/s 178 of the Income Tax Act or the Sales Tax Authorities u/s 530 of the Indian Companies Act. Even otherwise, it is contended that the State has no preferential claim over the rights of secured creditors even under the general law and consequently the State would have no right of preference over the proceeds from sale of the Bhandup property. It is then contended that the Companies Act is a complete Code by itself for payment to creditors and there can be no other priority for payment over the provisions of the Companies Act unless there is a statutory law to that effect. It is further

contended that section 529-A of the Companies Act overrides the provision of other Acts in respect of the claim of other creditors. Even otherwise, it is contended that the property was mortgaged to the applicants and all that was left to the mortgagor was the right of redemption. It is, therefore, contended that considering the above aspect the objections as raised must be rejected.

5. On behalf of the Official Liquidator, the Deputy Official Liquidator contends that section 529-A does not have an over-riding effect over section 178 of the Income Tax Act but is only restricted to inter se claims in respect of the secured creditors and workers. It is further contended that u/s 178 of the Income Tax Act, the income tax dues have a preferential right. If an order is made u/s 178 as has been held by the Apex Court in the case of Imperial Chit Funds (P) Ltd. v. Income Tax Officer, Vol. 219 Income Tax Reports page 498 and which has been considered by this Court by order dated 28th August, 1998 in Company Petition No. 910 of 1987 in the matter of M/s. Strait India Limited (in Liquidation), it has preference over the claims of secured creditors. Considering the above, the following questions need to be formulated for decision.

(1) Whether under the General Law, claims of the State have preferential rights over the claims of secured creditors?

(2) If not, whether section 178 of the Income Tax Act makes a claim of the State for Income Tax dues a preferential right over the rights of the secured creditors u/s 529-A of the Companies Act.?

(3) Whether the claims of workers u/s 529-A have preference over claims of tax dues u/s 178 of the Income Tax Act or Sales Tax Act.

The third question does not directly arise in the matter. It is, however, being answered as there are claims of workers and further to clarify the observations in M/s. Strait India Ltd. (in Liquidation).

6. It is, therefore, necessary to first deal with the contention whether under general law, the claims of the State for Tax dues have preferential rights over the claims of secured creditors. That matter need not detain us for long as in my opinion the issue is no longer res integra being covered by the Judgment of the Apex Court in the case of Collector of Aurangabad and Another Vs. Central Bank of India and Another, . In that case the firm Chandman Marmal was indebted to the Central Bank of India. The Central Bank of India thereafter filed a suit against the firm Chandman Marmal for recovery of an amount of Rs. 14, 541/- and odd. An injunction was granted against certain properties of the firm. The Court directed the firm to furnish security for the amount of the decree which may be passed against the firm in the suit. One Jogilal Mulchand, a partner of the firm on 28th April, 1955 furnished security by creating a charge on his Immovable property which was a house situated at Aurangabad. A decree was passed on 30th April, 1955. The Bank moved for execution of the decree. In execution, the house was sold to one Girdhardas. The auction was confirmed by the Court on 14th August, 1958 and the proceeds deposited in the execution Court. On 17th

August, 1958 the Sales Tax Officer wrote a letter to the District Judge claiming an amount of Rs. 9,672/- as due to the Government as arrears of sales tax. On 23rd September, 1958 District Judge directed the Subordinate Judge not to pay the sale proceeds of the house to the Bank, the decree-holder. Thereafter Collector of Aurangabad by an order, distrained the amount of Rs. 9,672/-out of the sale proceeds u/s 119 of the Hyderabad Land Revenue Act. The Bank moved an application challenging the order of the Collector. The same was rejected on the ground that the Civil Court would have no jurisdiction. In an Appeal preferred to this Court, a learned Single Judge dismissed the Appeal on the ground that the Bank has preferential claim in view of sections 104 and 119 of the Hyderabad Land Revenue Act. In Appeal preferred before a Division Bench of this Court, the Division Bench held that section 119 of the Hyderabad Land Revenue Act applied only to property which was in the custody and possession of the judgment debtor and not in the custody or possession of the Court. It was further observed that the priority was only in respect of land revenue and not in respect of the other taxes and that the Bank as a decree-holder had a prior charge as the quality of debt was not the same as that of the debt due to the Government and therefore in respect of the sales tax, the State had no priority. That is how the matter went to the Apex Court. We are not concerned with other aspects of the matter except the issue, whether the debt of the State has preference over the debts of secured creditors. In para 7 the Apex Court considered the Common Law doctrine of "Priority of Crown debts" as set out in Halsbury law of England, 3rd Edition, Vol. 7 P. 221. The Apex Court quoted the following observations:-

"The royal prerogative may be defined as being that pre-eminence which the Sovereign enjoys over and above all other persons by virtue of the Common Law, but out of its ordinary course. In right of her regal dignity, and comprehends all the special dignities, liberties, privileges, powers and royalties allowed by the common law to the Crown of England."

The Court also observed that this Court in *Secretary of State in Council for India v. Bombay Landing and Shipping Co. Ltd.*, (1868) 5 Bom. H.C.O.C. 23, had held that a judgment debt due to the crown was entitled to the same precedence in execution as alike judgment debt in England, if there is no special legislative provision affecting that right in the particular case. This view was reiterated by Chagla, C.J., in *Bank of India Vs. John Bowman and Others*, . This view was followed by a Full Bench of the Madras High Court in *Manickam Chettiar v. Income Tax Officer, Madura*, AIR 1938 Mad 360. After considering all the judgments, the Apex Court held that the English Common Law doctrine having been incorporated into Indian Law, was a law in force in the territory of India and by virtue of Article 372(1) of the Constitution of India it continued to be in force until it was validly altered, repealed or amended, All these authorities had been quoted and approved by the Apex Court in *Builders Supply Corporation Vs. The Union of India (UOI) Represented by the Commissioner of Income Tax, West Bengal and Others*, , which had taken the view that the Income tax claims of the Government of India were entitled to preference over debts of unsecured

creditors. It was sought to be argued that the said view of the Apex Court had been modified by the subsequent judgment of a Larger Bench in the case of Superintendent and Legal Remembrancer, State of West Bengal Vs. Corporation of Calcutta, . The Apex Court held that there was nothing in that Judgment which affected the law as declared in the case of Builder Supply Corporation (supra). The Apex Court noted that the majority judgment of the learned Chief Justice had referred to the decision in H. Snowden Marshall v. People of the State of New York, 1920(65) L Ed. 315, which lays down a similar doctrine, namely that the State of New York has the common law prerogative right of priority over unsecured creditors. Therefore, it is clear that the priority of the State is qua unsecured creditors and not qua secured creditors. Having said so the first contention of the applicants must be accepted that the Common Law doctrine which has been recognised in India and saved is that the claims of the Crown prevail over the claims of unsecured creditors and not over secured creditors. Imperial Chit Funds (supra) is therefore an authority for the proposition that between unsecured creditors, the claim of tax dues u/s 178 of the Income Tax Act, would have preference over all the claims of unsecured creditors.

7. That brings us to the second and third questions viz. whether section 178 of the Income Tax Act has made any difference and/or it prevails over the provision of section 529(A) of the Indian Companies Act. It was sought to be contended on behalf of the Deputy Official Liquidator that considering the judgment in Imperial Chit Fund (Supra), the Income Tax dues u/s 178 of the Income Tax Act will prevail over the rights of the secured creditors. A careful analysis of the said judgment would show that the issue whether an order passed u/s 178 of the Income Tax Act would have preference over the rights of secured creditors was not in issue before the Apex Court. In the case of Imperial Chit Fund (supra) as already observed what was in issue before the Apex Court was qua section 530(1) (a) i.e., over unsecured creditors. It is in that context, considering the provision of section 178 of the Income Tax Act, the Apex Court held, if an order was passed u/s 178, bearing in mind that the amendment was brought by the Income Tax Act, 1961 and considering the equality amongst the creditors as set out in section 530(5) the order u/s 178 for Income Tax dues would have preference over other unsecured creditors set out in section 530(1). The said judgment had come up for consideration before me in Company Petition No. 910 of 1987 in M/s. Strait India (supra). In that case after the Official Liquidator had been appointed and during the pendency of the proceedings properties belonging to the Company were sold. The question was whether Capital Gain Tax would have preference over the claims of secured and unsecured creditors. It was contended on behalf of the Income Tax Department that another Judgment of this Court in the case of (Polyolefin's Industries Ltd. v. M/s. Kosmek Plastics Mfg. Co. Ltd., Company Petition No. 44 of 1986 wherein the Court held that the claim of the workers would have preferential rights over that of Tax Authorities was passed without considering the judgment of the Apex Court in Imperial Chit Fund (supra). In Polyolefin's Industries Ltd. (supra). A. P. Shah., J., was considering a

case where there were no secured creditors except the claims of the workers u/s 529-A of the Companies Act. By virtue of section 529-A of the Companies Act the claims of the workers are *pari passu* with the claim of the secured creditors. The learned Single Judge held that claims of the workers would have preference over tax dues. It is true that the question as framed by me in *M/s. Strait India Ltd.* was whether the Capital Gains Tax payable u/s 45 of the Income Tax Act has precedence over the claim of other secured creditors covered by section 530 read with section 529-A of the Companies Act. I had negated the contention of the Tax Department after considering the judgment of the Imperial Chit Fund (*supra*) on the ground that section 178 is restricted to an order in respect of dues passed after notice was issued to the Assessing Officer u/s 178 of the Income Tax Act and within the time as set out therein and will not apply to subsequent tax dues. In the said Judgment what really was in issue, was whether the tax dues of the State under Income Tax Act have preference over the dues of workers. The question whether the claims of Income Tax dues, have preference over claims of secured creditors was not at all in issue. If section 529-A is considered it is clear that it has an overriding effect. Section 529-A was brought in by an amendment and was inserted in the Companies Act by Act of 1985. The section makes it clear that notwithstanding anything contained in other provisions of the Act or any other law for the time being in force, dues of workers and debts due to the secured creditors to the extent such debt rank under Clause (c) of the provisions of sub-section (1) of section 529 *pari passu* with such dues shall be paid in priority over all other debts. To that extent it can be said that the question as posed in *M/s. Strait India Ltd. (in Liquidation)* was not really required to be answered as workers dues u/s 529-A have preference over tax dues u/s 178 of Income Tax Act as they are considered *pari-passu* with the claims of secured creditors. The amendment to the Income Tax Act was brought in 1961. Both are central legislations. Therefore looking at the literal language of the two sections it would be clear that the rights of the secured creditors would prevail over the rights of all other creditors. As seen from the Judgment of Imperial Chit Fund (*supra*) the question posed by the Apex Court was whether the claim of tax would have precedence over the claim of the other creditors u/s 530 in view of the provisions of sub-section (5) of section 530 of the Companies Act. It is to that extent that the Apex Court held that an order passed u/s 178 of the Income Tax Act will prevail over the rights of other unsecured creditors u/s 530 of the Companies Act. This is also the view taken by a learned Single Judge of the Kerala High Court in the case of (*Giovanola Binny Ltd. (In Liquidation)*), 1990(67) Company Cases 441. Though this question was not directly posed in the case of *Polyolefin's Industries Ltd. (supra)*, the learned Single Judge while construing the provisions held that in view of section 529-A of the Companies Act the claims of the workers would have preference over that of Tax authorities u/s 178 of the Income Tax Act.

8. Once having so held, it is now clear that both under the general law as well under the provisions of the Companies Act read with the provisions of the

Income Tax Act the rights of secured creditors and workers as set out u/s 529-A would override the claims of tax authorities in respect of an order made u/s 178 of the Income Tax Act. Having said so, the objections raised on behalf of the Official Liquidator must be rejected.

I may mention here that my attention was invited to the judgment of the Division Bench of the Andhra Pradesh High Court in the case of Income Tax Officer, B-Ward, Company Circle Hyderabad v. Official Liquidator, 1976 (46) Comp Cas 46. The Division Bench of the Andhra Pradesh High Court has not taken any different view. There also what was under consideration was the claim of the unsecured creditors and claims u/s 530(1)(a) read with the demand u/s 178 of the Income Tax Act.

9. The question is what relief is to be granted in so far as the Company Application No. 116 of 1998 and Company Application No. 117 of 1998 are concerned. It has been brought to my notice that the claim by the applicants in both the cases is beyond time and there is no application for condonation of delay. In the light of that prayer (b) in Company Application No. 116 of 1998 cannot be considered as also prayer (a) in Company Application No. 117 of 1998. Considering the above at this stage, I do not propose to consider prayer Clause (b) in Company Application No. 116 of 1998 and prayer Clause (a) in Company Application No. 117 of 1998 as even otherwise, the amounts claimed considering the claims of the workers and the claim of the secured creditors, being *pari passu*, *pro-rata* would be to the extent 50% of the sale proceeds. However, liberty to the applicants for taking out an application for condonation of delay, and to reapply for the reliefs.

In so far as the prayer (a) in Company Application No. 116 of 1998 is concerned there can be no objection to the same as it is the amount spent by way of expenses for sale. It is true that it has not been possible to separate the costs towards the two properties. That can be obviated by proportionately apportioning the costs bearing in mind the sale proceeds realised in the sale of the two properties.

There has been another prayer by the applicants that money be deposited with them and that they are willing to give higher rate of interest compared to the interest presently received by the office of the Official Liquidator. The said offer can be made at the same time if the application for payment of part proceeds is made, if so advised as earlier set out. The deposits which have matured can be reinvested upto 31st March, 1999.

10. In the light of that in Company Application No. 116 of 1998 rule made absolute in terms of prayer Clause (a) with interest at the rate of 11% per annum.

In the circumstances of the cases all parties to bear their own costs.

11. Rule made absolute in terms.