

Imperial Chit Funds (P) Ltd.

Vs

Income-tax Officer, Ernakulam

Civil Appeal No. 1199 (NT) of 1979

(B. P. Jeevan Reddy, K. S. Paripoornan JJ)

19.03.1996

JUDGEMENT

PARIPOORNAN, J.

1. The appellant herein is M/s. Imperial Chit Funds Private Limited, a company in liquidation, represented by the Official Liquidator, High Court of Kerala. The respondent is the Income-tax Officer, Ernakulam (the Revenue). The Liquidator has filed this appeal from the order passed by a full Bench of the High Court of Kerala dated 10-8-1978 and rendered in report No. 53 in C.P. No. 7 of 1973. In the said report of Official Liquidator prayed that orders may be passed holding that income-tax claimed by the revenue is not payable at that stage, and that the Income-tax Officer should wait and prove his claim before the Official Liquidator when the list of creditors is settled. The Full Bench, by the judgment appealed against, negatived the said prayer made by the Official Liquidator in his report. It is against the aforesaid judgment the Official Liquidator representing the Imperial Chit Funds Private Limited has come up in appeal.

2. The Imperial Chit Funds Pvt. Ltd. is a private company. it wound up as per orders passed by the High Court dated 1-6-1973 in C. P. No. 7 of 1973. After the commencement of the winding up proceedings the Income-tax Officer finalised the assessment of the company for the year 1972-73 by his order dated 31-3-1975. He assessed the company to income-tax in the sum of Rs. 934/- and levied an interest of Rs. 93/- payable under Section 220(2) of Income-tax Act. The total amount thus payable was Rs. 1,027/-. The Official Liquidator intimated the Income-tax Officer by his letter dated 8-5-1975 that the tax and interest constituted debt provable in the winding up proceedings. He stated that he was not in a position to pay amounts straightway. According to the Liquidator, the tax was due and payable within 12 months before the relevant date mentioned in Section 530(8) (c) of the Companies Act and so, Section 530(1) (a) of the said Act will not apply to the instant case. The Income-tax Officer ignored the above intimation of the Official Liquidator. He issued a certificate to the Tax Recovery Officer and by his letter dated 8-12-1976 demanded a sum of Rs. 1,027/- to be paid immediately. A notice of demand was accordingly issued. He also wrote to the Official Liquidator by communication dated 15-1-1977 for payment of the amount as per the notice of demand. Thereupon the Official Liquidator filed report No. 53 dated 20-1-1977, seeking appropriate directions of the Court to the effect that the tax claimed is not payable at that stage, and that the Income-tax Officer should wait and prove his claim, when the list of creditors is settled. The learned Company Judge took the view that an important question arises for consideration, namely, whether the legal effect of Section 178 of the Income-tax Act is that the income-tax Officer is entitled to the payment of the tax demanded otherwise than as provided in the Companies Act. He also referred to an earlier Division Bench decision of the High Court of Kerala rendered in A.S. No. 224/1968 wherein it was held that the amounts "set aside" under Section 178 of the Income-tax Act will be

available for distribution in accordance with the provisions of the Companies Act and, therefore, there was no question of any priority in the distribution of assets. In view of some subsequent decisions, the learned Company Judge felt considerable doubt about the correctness of the aforesaid decision and referred the matter for being heard by Division Bench. The Division Bench of the High Court of Kerala before whom the matter came up, by order dated 27th June, 1997 referred the matter to a full bench for decision and accordingly the matter was finally heard and decided by a Full Bench. The judgment of the Full Bench is reported in 116ITR 176:(AIR 1979 Kerala 23) (FB).

3. We heard Counsel for the appellant Mr. K. John Mathew and Senior Counsel for the respondent-Revenue Mr. J. Ramamurthy. The sole question that arises for consideration in this case is, whether Section 178 of the Income-tax Act affects or alters the existing law of priority or overrides the provisions of preferential payment provided in Section 530 of the Companies Act. There are conflicting decisions on this point. A learned single judge of the High Court of Kerala, in *Income-tax Officer, Ernakulam v. Indian Traders Bank Ltd. (In Liquidation)*, 1968 Ker LT 595, took the view that Section 178 of the Income-tax Act does not affect the scheme of priority in Section 530 of the Companies Act, but, the amount "set aside" under Section 178 of the Income-tax Act will not be available for distribution in accordance with the provisions of the Companies Act and should be first applied to the satisfaction of the tax liability and gets priority over other debts of the Company, in the same way, as a secured creditor, who stands outside the winding up. The said decision was affirmed in appeal by a Division Bench in A.S. No. 225 of 1968. A Division bench of the Andhra Pradesh High Court in *income-tax Officer, B. Ward, Company Circle, Hyderabad v. Official Liquidator*, 101 ITR:(1974 Tax LR 2365) has taken the same view. On the other hand, the High Courts of Mysore, Calcutta, Rajasthan, Gujarat and Delhi, in the decisions reported in *income-tax Officer, Company Circle, Bangalore v. Official Liquidator*, Mysore High Court, (1967) 63 TR 810 (Mysore), *Official Liquidator, High Court, Calcutta v. Commr, of Income-tax*, 80 ITR 108:(AIR 1970 Calcutta 349), *Commr. of Income-tax (Central), New Delhi v. Official Liquidator, Golcha Properties (Pvt.) Ltd., (In Liquidation)* 95 ITR 488:(9174 Tax LR 55) (Rajasthan), *Baroda Board & Paper Mills Ltd.(In Liquidation) v. Income-tax Officer, Circle I, Ward-E, Ahmedabad*, 91976) 102 ITR 153 (Gujarat), *Income-tax Officer, Company Circle XVII, New Delhi v. Narula Finance P. Ltd. (In Liquidation)*, 114 ITR 645 : (1978 Tax LR 1158) (Delhi), and *Income-tax Officer, District Ii (2) Additional, New Delhi v. Official Liquidator, National Conduits (P) Ltd.*, 128 ITR 228 :(1981 Tax LR 369) (Delhi) have taken a contrary view and have held, that the provisions of Section 178 of the Income-tax Act do not affect or alter the existing law of priority and do not override the provisions for preferential payment contained in Section 530 of the Companies Act. (Incidentally, we may state that the decision of Gujarat High Court reported in (1976) 102 ITR 153 was reversed by this Court in the decision reported in 189 ITR 90 (2): (1991 AIR SCW 647) on some other aspect and the same is not relevant herein). The sole question for out consideration is, which or the rival views is correct.

4. In order to appreciate the controversy in question, it will be useful to bear in mind the relevant provisions of the Income-tax Act, 1961 and the Companies Act, 1956. The relevant provisions are extracted hereinbelow:

Income-tax Act, 1961

"178. Company in liquidation.-- (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 Assessing Officer who is entitled to assess the income of the company.

(2) The Assessing Officer shall, after making such inquiries 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 Assessing 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 Chief Commissioner or Commissioner, part with any of the assets of the company or the properties in his hands until he has been notified by the Assessing 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 amount, 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 and expenses of the winding up of the Company such costs and expenses of the winding up of the company as are in the opinion of the Chief Commissioner or 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."

(Emphasis supplied)

Provisions of the Companies Act, 1956

"Suit stayed on winding up order.

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.

(2) 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--

(a) any suit or proceeding by or against the company;

(b) any claim made by or against the company (including claims by or against any of its branches in India);

(c) any application made under Section 391 by or in respect of the company;

(d) any question of priorities or any other question whatsoever, of law fact, which may relate to or arise in course of the winding up of the company ;

Whether such suit or proceeding has been instituted, or is instituted, or such claim or question has arisen or arises or such application has been made or is made before or after the order for the winding up of the company, or before or after the commencement of the Companies (Amendment) Act, 1960.

(3) Any suit or proceeding by or against the company which is pending in any Court other than that in which the winding up of the company is proceeding may, notwithstanding anything contained in any other law for the time being in force, be transferred to and disposed of by that Court."

"Effect of winding up order.

447. An order for winding up a company shall operate in favour of all the creditors and of all the contributories of the company as if it had been made on the joint petition of a creditor of a creditor and of a contributory."

"Custody of company's property.

456. (1) Where a winding up order has been made or where a provisional liquidator has been appointed, the liquidator or the provisional liquidator, as the case may be, shall take into his custody or under his control, all the property, effects and actionable claims to which company is or appears to be entitled."

"Distribution of property of company.

511. Subject to the provisions of this Act as to preferential payments, the assets of a company shall, on its winding up, be applied in satisfaction of its liabilities *pari passu* and, subject to such application, shall, unless the articles otherwise provide, be

distributed among the members according to their rights and interests in the company."

Inserted by the Companies (Amendment) Act, 1985:

"Overriding preferential payments.

529. (1) Notwithstanding anything contained in any other provision of this Act or any other law for the time being in force, in the winding up of a company--

(a) workmen's dues; and

(b) debts due to secured creditors to the extent such debts rank under clause 9c0 of the proviso to sub-section (1) of Section 529 pari passu with such dues shall be paid in priority to all other debts.

(2) The debts payable under clause (a) and clause (b) of sub-section 91) shall paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions."

"Preferential payments.

530.(1) In a winding up, subject to the provisions of Section 529 A, there shall be paid in priority to all other debts--

(a) all revenues, taxes, cesses and rates due from The company to the Central or a State Government or to a local authority at the relevant date as defined in clause (c) of sub-section (8) , and having become due and payable within the twelve months next before that date;"

(Emphasis supplied)

5. Counsel for the appellant Mr. John Mathew laid stress on Sections 446, 447, 529 (1) (b), 530 (1) (a) besides Sections 448A, 449, 451, 456(2), 457(a), 511, 528 and 529 of the Companies Act to show that the Official Liquidator is in full charge of the Company in liquidator and that the properties and assets of the company are in the custody of the Court. It was further contended that Section 530(1) (a) of the Companies Act provides for preferential payment of revenues, taxes cesses and rates due from company to the Central or the State Government or a local authority, and the Companies Act is a complete Code providing for all matters inclusive of the manner or payment of debts of the company in liquidation. According to Counsel, Section 178 of Income-tax Act, only provides for the procedure to be followed by the person incharge of the company in liquidation and information to be given to appropriate persons regarding income-tax dues, and the said Section does not provide for priority of payments. It was contended that Section 178 of the Income-tax Act is only limited in its operation, and does not provide for preferential payments or priority of payments, as provided in Section 530 of the Companies Act. The argument was that Section 178 of the Income-tax Act and the relevant provisions of the Companies Act referred to herein are distinct and provide for different contingencies. If it is not so understood, and Section 178 of the Income-tax Act is interpreted as one providing for preferential payment also, it will lead to disastrous consequences and completely set at naught the scheme and the relevant provisions of the Companies Act with regard to the winding up proceedings. Since the stage for deciding for preferential payment has not

reached, the Income-tax Officer had no right to call upon the liquidator to pay the amount and should wait for the stage when he can prove the claim in the winding up proceedings. The interpretation placed by the High Court on Section 178 of the Income-tax Act as if it provides for a preferential payment of income-tax dues, has failed to give effect to the relevant provisions of the Companies Act and the significance of the winding up proceedings in its proper context. The High Courts of Mysore, Calcutta, Rajasthan, Gujarat and Delhi have understood Section 178 of the Income-tax Act as not in any way providing for priority of payment regarding income-tax dues and the view expressed by the Kerala and the Andhra Pradesh High Court to the contrary does not lay down the correct law. On the other hand, Counsel for the revenue submitted that the decisions of the Kerala and the Andhra Pradesh High Courts have given due importance to the legislative history and background leading to the enactment of Section 178 of the Income-tax Act and the crucial words contained in the section to hold that Section 178 of the Income-tax Act is a special provision and the amount which is to be set aside as per the said section, stands outside the winding up proceedings and is not available for distribution in accordance with the provisions of the Companies Act at all. Counsel for the revenue further argued that the preferential payment specified in Section 530 (1) (a) of the Companies Act and the mandate under Section 178 of the Income-tax Act behaving the Liquidator to set aside the amount notified by the Income-tax Officer, sufficient to provide for any tax which is then or is likely thereafter to become due and payable by the Company are of different import and the view taken by the Kerala and Andhra Pradesh High Court that Section 178 of the Income-tax Act, mandating that the amount "set aside" should be first applied to the satisfaction of the tax liability, and is outside the winding up proceedings, is justified in law. It was further contended that except the Kerala and Andhra Pradesh High Court, the other High Courts have failed to give due importance to the legislative history and background which led to the enactment of Section 178 of the Income-tax Act and the language used in the section.

6. In the judgment under appeal the High Court has referred to the legislative history and background that led to the enactment of Section 178 of the Income-tax Act, 1961. The High Court has referred to the report of the Company Law Reforms Committee which has been referred to in the decision of the Andhra Pradesh High Court, wherein the plea for priority of tax demands, particularly income-tax, was dealt with and it was observed that preferential right without limit should not be conferred. The committee's recommendations were not completely accepted by the legislature. That apart, the report of the Direct Taxes Administration Inquiry Committee was referred to (Srinivasan's book on Income-tax Volume II, page 345), wherein necessity was pointed out, for the Liquidator to obtain tax clearance certificate or to compel him to set aside the amounts to cover the amounts due under income-tax or amounts which may become due, and it was thereafter, Section 178 of the Income tax Act, 1961 was enacted in the present form. After referring to the above materials in paragraph No. 4 of the Judgment, the Full Bench of the High Court observed, thus :-

"With respect, these decisions (Decisions of other High Courts) fail to take note of the object and purpose with which Section 178 of the Income-tax Act was put into the statute book; and the significance and the implications of "setting aside" of an approximate amount needed to meet the tax liability of the company. These have been noticed in the Kerala and the Andhra Pradesh decisions to which we shall refer. Before we do so, we May briefly indicate that the effect of Section 178 (3) (b) is that the amount "set aside" by the Liquidator is marked off as outside the area of the winding up proceedings and the jurisdiction of the winding up court. This is the view taken by the Kerala High Court and we are in agreement with it;"

We would only add that the scope of Section 530 (1) (a) is different from that of Section 178 of the Income-tax Act. Under Section 530 (1) (a) all taxes which have "become due and payable" alone are entitled to preferential payment. The amount should have been crystallised into a liability. Under Section 178 (2) read with Section 178 (3) of the Income-tax Act, provision should be made for any tax which is then or is likely thereafter to become payable. Even the amounts which have not been crystallised into a liability, but which are "likely to become due thereafter "should be taken note of. And, we should also bear in mind, the non-obstante clause -- Section 178 (6) of the Income-tax Act.

7. In the judgment under appeal, the Full Bench has followed the judgment of a learned single Judge of the Kerala High Court in *I. T. O. Ernakulam v. Indian Traders Bank Ltd.*, 1968 Ker LT 595. In the said decision Raman Nair, Acting Chief Justice, a judge with considerable experience in company law, dealt with Section 178 of the Income-tax Act and Sections 529 and 530 of the Companies Act, and observed in his characteristic style, thus:-

"One wishes that Section 178 of the Income-tax Act, 1961 were more explicit, but as I read that provisions, I do not think that it affects the scheme of priority in Section 530 of the Companies Act although its effect no doubt is that the amount set aside under sub-section (3) thereof has first to be applied to the satisfaction of the tax liability and in that sense the tax liability gets priority over the other debts of the company in the same way as a secured creditor who stands outside the winding up, or whose security is redeemed under subsection (4) of Section 74 of the Provincial Insolvency Act read with Section 529 of the Companies Act, gets priority to the extent of the value of his security. But, although sub-section (3) of Section 178 of the Income-tax Act, which speaks of the liquidator making "payment to secured creditors whose debts are entitled under law to priority of payment over debts due to Government"-- the only payment I can think of by the liquidator to a secured creditor who has not relinquished his security is a payment under sub-section (4) of Section 47 of the Provincial Insolvency Act, or to a creditor who, although he has not relinquished his security, has agreed to the liquidator selling the property free of his incumbrance on condition of his being given the same charge over the sale proceeds-- seems to regard these as cases of priority, they are really not so much cases of priority as of the particular asset not being available for distribution among the creditors in the winding up. They stand on the same footing as, for example, trust funds. What is really available for distribution are the assets which come into the hands of the Liquidator minus the trust monies, or the incumbrance of a secured creditor, or, in a case falling under Section 178 of the Income-tax Act, the amount set aside or earmarked for the payment of the tax. For, reading sub-section (2), (3) and (4) of that Section together there can be no doubt that what the Section does is to create a first charge on the amount set aside by sub-section (3) thereof for payment of the tax that might be admitted to proof. To say as the liquidator has done that the amount is set aside only for the purpose of paying the dividends that might be declared in respect of the tax liability and not the entire liability as proved in the winding up, so that the section serves only the limited purpose of ensuring that the assets of the company are not distributed beyond recall without reserving sufficient funds for the payment of dividends in respect of the tax liability which might nor yet have been determined, and therefore not proved, is hardly in keeping with the wording of the Section defective though it be. Sub-section (2) of the Section, it may

be noted, speaks of the tax payable by the company, and sub-section(4), of the payment of the tax on behalf of the company, not of the dividends payable in respect of the tax liability. What the Section contemplates is the payment of the tax eventually found due out of the amount set aside, not the payment of dividends in respect of the tax eventually found due. And, if of the this brings the section into conflict with Section 530 of the Companies Act, the section must prevail by reason of sub-section (6) thereof-- the question why income-tax alone of all Government dues should ride this high horse is not for me to answer. But, for the purposes of Section 530 of the Companies Act, the tax liability is an ordinary and not a preferential claim and it is only of the amount set aside under sub-section (3) of Section 178 of the Income-tax Act that the Revenue can claim payment of its debt to the exclusion of other creditors."

And the Division Bench in A. S. No. 225/19689, affirming the above decision, observed thus :-

".....We cannot ignore the provision in sub-section (2) of Section 178 that the amount to be notified is not only the amount for which preference is given under Section 530 of the Companies Act, 1956 but the entirety of the income-tax dues of the company including that which may thereafter become payable. When we read this provision with the provisions in sub-section (4) of Section 178 of the Act which makes Liquidator personally liable for the payment of the Tax which the company would be liable to pay if the Liquidator failed to give notice in accordance with sub-section (1) of Section 178, it appears to us that the provision in Section 178 (3) imports much more than that was contended by Counsel for the appellant. This is the view that has been taken in the judgment under appeal which, if we may say with great respect, deals with all aspects in a few sentences. We respectfully agree with the view taken by the learned Judge."

Approving the above dicta, the Full Bench has further laid stress on the crucial words occurring in Sections 178 (2), 178 (3) (b) of the Income-tax Act, which behoves the official Liquidator to "set aside the amount" equal to the amount notified by the Income Tax Officer and held that these words mean "keeping separate for special purpose" and the words "set aside" or "set apart" are synonymous with the word "appropriate". The Full Bench has observed in paragraph 6 of the judgment thus:-

"The shades of meaning thus attached to the expression 'set aside' convey the idea of an appropriation or an allocation of the income-tax dues; with the result, that it stands outside the winding up by the Company Court -- an idea suggested in the judgment of Ag. Chief Justice Raman Nayar, confirmed by the Division Bench."

The Andhra Pradesh High Court in the decision reported in I. T. O. v. Official Liquidator, 101 ITR 470 : (1974 Tax LR 2365), has taken a similar view. We are of the opinion that the judgment of the learned single Judge of the Kerala High Court in I. T. O. v. Indian Traders Bank Ltd., 1968 Ker LT, affirmed in A. S. No. 225/68 and approved by the Full Bench in the judgment under appeal as also the decision of the Andhra Pradesh High Court in I. T. O. v. Official Liquidator, 101 ITR 470 : (1974 Tax LR 2365), lay down the law correctly. On a total view of the relevant statutory provisions, it appears to us, that the Income Tax Department, is treated as a "secured

creditor". The decisions of the Mysore, Calcutta, Rajasthan, Gujarat and Delhi High Courts have failed to give due importance to the legislative history and background that led to the enactment of the section and the crucial words occurring in Sections 178 (3) and 178 (4) of the Income-tax Act to the effect that the Official Liquidator "shall set aside" the amount notified by the Income Tax Officer and if it is not so done, the Official Liquidator is personally liable to pay the amount of tax which the company would be liable to pay. It should be remembered that Section 178 of the Income-tax Act occurs in Chapter XV of the Act. The object sought to be achieved by the provisions in the said Chapter is "to fasten liability to pay the tax" on the income received and to catch the income at the earliest point of time and tax the same where it is found, instead of waiting for long. We, therefore, hold that the judgment under appeal does not merit interference by this Court.

8. During the course of hearing, our attention was drawn to Section 17 of the Central Sales Tax Act, 1956 which is similar to Section 178 of the Income-tax Act, 1961. We are of the view that the interpretation placed by us on Section 178 of the Income-tax Act, should govern cases arising under Section 17 of the Central Sales Tax Act, 1956 as well. But a situation may arise where the authorities under both the Acts (Income-tax Act as well as Central Sales Tax Act) send similar orders to the Official Liquidator, in which case the question of precedence may arise. In our opinion, in such cases, the priority shall be with respect to the date of receipt of the orders by the Official Liquidator.

9. We affirm the judgment under appeal. This appeal is without merit and is, therefore dismissed. There shall be no orders as to costs. Appeal dismissed.