SUPREME COURT OF INDIA

SRI MOHAN WAHI

Vs.

COMMISSIONER, INCOME-TAX, VARANASI & ORS.

30/03/2001

(CJI, R.C. Lahoti & Doraiswamy Raju.)

Appeal (civil) 2488 of 2001

JUDGMENT

R.C. Lahoti, J.

The relevant facts are jejune and beyond any pale of controversy. Late Bhagwati Prasad owned a house property described as D-53/91-D, Luxa, Varanasi (hereinafter referred to as the house property). He had four sons - namely, P, S, R and K. Under his will of the year 1962, probated in the year 1965, the house property devolved upon his four sons. The elder two sons - P and S, had entered into a partnership known as M/s United Provinces Commercial Corporation, Luxa, Varanasi (UPCC, for short) dealing in import and sale of heavy machinery and road rollers. The labour troubles resulted in the firms business collapsing in the year 1967. The partners left Varanasi and migrated elsewhere. In the year 1972, Income-tax assessments of the firm UPCC were finalised for the assessment years 1967-1968 to 1969-1970. Recovery certificates were issued in 1973- 1974 pursuant whereto the house property was attached. On 3.12.1979 a proclamation for sale of the property was issued setting out a demand of Rs.30,82,000/- and upset price at Rs.1,70,000/-. On 11.1.1980, at the public auction, respondent no.3 made a bid proposing to purchase the property for Rs.1,70,000/- (which was the upset price). The bid was accepted by the officer conducting the sale. An amount of Rs.42,500/- being 1/4th of the auction money, was deposited by the auction-purchaser on 11.1.1980 simultaneously with the acceptance of the bid. The balance amount of Rs.1,27,500/- was deposited on 25.1.1980 within the prescribed period of 15 days.

R, the third brother had died. His widow, Padma, filed a civil suit in the Court of Civil Judge, Varanasi submitting that the undivided property of the four brothers and in any case the share of the brothers, who were not the partners in the firm, could not have been attached and advertised for sale for recovery of dues against the firm. She also sought for an ad interim restraint on sale. On 9.1.1980, the Court of Civil Judge deemed it not proper to stay the auction sale but nevertheless felt a prima facie case having been made out to stay the confirmation of the auction sale. Accordingly, the Union of India and the authorities of the Income-tax department were directed, through an ad-interim injunction, not to confirm the sale. In the year 1984 the auction-purchaser, respondent no.3 herein, was also impleaded as a party to the suit. The ad-interim injunction continued to operate until the suit itself came to be dismissed in default of appearance on 12.1.1998. On 13.1.1998 an application for restoration of the suit was filed. On 30.7.1999 the suit was restored to file.

The assessments made against the firm UPCC were all ex-parte and a substantial part of the demand

raised against the firm consisted of penalty and interest. The firm agitated the matter in the hierarchy of Income-tax Department. The challenge to the orders of assessment failed before the Commissioner of Income Tax (Appeals) who dismissed the appeals relevant to assessment years 1967-1968 to 1970-1971 as having been filed beyond the prescribed period of limitation. Four appeals were filed before the Income-tax Appellate Tribunal, Bench Allahabad. By an order dated 11.12.1987 all the four appeals were allowed. The Tribunal formed an opinion that there was sufficient cause which had prevented the assessee from filing the appeals before the CIT (A) in time and therefore the appeals were liable to be restored on the file of CIT (A) to be dealt with on merits. It was ordered accordingly. During the course of its order the Tribunal upheld a finding of fact recorded by the CIT (A) that the assessee could not be said to have been served with the demand notice. On being so remanded, the appeals were heard on merits by the CIT (A). Most of the matters relating to demand on account of tax, penalty and interest were resolved at the stage of CIT (Appeals) while the tax demand referable to 1967-1968 was resolved before the Tribunal. The fact remains that on different dates in the year 1989 the several demands against the assessee firm had all stood wiped out and therefore reduced to nil. On 26.3.1990 the Income-tax Officer, Ward II, Varanasi wrote to Commissioner of Income-tax, Allahabad that various demands raised against the assessee firm had stood reduced to nil. On 22.11.1996 the assessee firm, M/s UPCC wrote to the Income-tax Officer, Ward II, Varanasi that all demands of tax and penalties having been cancelled/liquidated, refunds were due and the Tax Recovery Officer may be advised for cancellation of all the recovery certificates. Copy of the application was endorsed to the Tax Recovery Officer. On 16.1.1997 the advocate for the assessee firm wrote to the ITO, Ward-II, Varanasi that in view of all the demands against the firm having ceased to exist and instead refunds having become due to the firm, it may be confirmed that all the recovery certificates issued for demands against the firm had stood withdrawn/cancelled. A copy of communication dated 26.3.1990 from ITO, Ward II, Varanasi to the Commissioner of Income-tax was annexed with the letter.

In spite of the abovesaid communications, on 25.3.1998 sale in favour of respondent no.3 was confirmed by the Tax Recovery Officer though only as regard the interest of P and S in the house property and a sale certificate was also issued to respondent No.3. The order of the Tax Recovery Officer confirming the sale was put in issue before CIT, Varanasi by the firm UPCC and its partners P and S, by filing a petition under section 264 of the Act. Vide order dated 21.5.1999, the CIT dismissed the petition forming an opinion that whatever happened after the auction sale held on 11.1.1980 was immaterial and the Tax Recovery Officer had no other option except to confirm the sale. S, the petitioner before us then filed the present writ petition laying challenge to the order of Tax Recovery Officer confirming the sale and issuing sale certificate to respondent No.3 also to the order of C.I.T. dated 21.5.1999. The fact that all the demands against the firm (and the partners) had ceased to exist by 1996 and 1997 is a fact positively asserted in para 5 of the writ petition filed before the High Court and not denied in the counter-affidavit filed on behalf of the Commissioner of Income-tax. So also the fact that the demands against the firm UPCC had stood cancelled and this fact was communicated by the ITO, Ward II, Varanasi to the Commissioner of Income-tax, Allahabad through his letter dated 26.3.1990 is also admitted in the counter- affidavit. However, the petition has been dismissed by the High Court. The aggrieved petitioner has filed this petition for special leave under Article 136 of the Constitution.

Leave granted.

Two questions arise for decision in this appeal :

i) Whether the Tax Recovery Officer could have confirmed the sale on 25.3.1998 when the demands on account of tax for the recovery of which tax recovery certificates were issued had admittedly ceased to exist; and

ii) What is the effect of a notice of demand under Section 156 of the Income-tax Act, 1961 having not been served on the assessee on the sale held for recovery of arrears of income-tax?

Taking up first question the first, according to Section 222 where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may issue a certificate specifying the amount of arrears due from assessee and shall proceed to recover from such assessee the amount so specified by one or more of the modes which include attachment and sale of the assessees immovable properties. The Second Schedule sets out the procedure for recovery of tax. We will refer to some of the rules contained in the Second Schedule and relevant for our purpose. Rules regarding attachment and sale of immovable property are contained in Part III of Second Schedule. Rule 56 provides that the sale shall be by public auction to the highest bidder and shall be subject to confirmation by the Tax Recovery Officer. Several provisions contained in the rules which follow Rule 56 are in pari materia with the provisions dealing with attachment and sale of immovable property contained in Order 21 of the C.P.C. dealing with execution of decrees passed by civil courts. However, in Order 21 of the C.P.C., a provision similar to Rule 56 of Second Schedule is not to be found. Rule 60 provides for an application to set aside sale of immovable property being made by defaulter or an interested person on his depositing the specified amount within 30 days from the date of sale. Rule 61 deals with application to set aside sale of immovable property on the ground of non-service of notice on the defaulter under the Schedule or on the ground of material irregularity in publishing or conducting the sale. Under Rule 62 a sale may be set aside on an application by the purchaser on the ground that the defaulter had no saleable interest in the property sold. The prescribed time limit within which the application can be made under Rule 60, 61 or 62 is 30 days from the date of sale. Where no application is made for setting aside the sale or such an application having been made is disallowed, the Tax Recovery Officer shall make an order confirming the sale and thereupon the sale shall become absolute. On a sale or immovable property becoming absolute, a sale certificate shall be issued under Rule 65.

Under Section 224, an assessee cannot dispute the correctness of any certificate drawn up by the Tax Recovery Officer but it is lawful for the Tax Recovery Officer to cancel the certificate for any reason if he thinks it necessary to do so or to correct any clerical or any arithmetical error therein. Sub-section(3) of Section 225 provides as under:-

225. Stay of proceedings in pursuance of certificate and amendment or cancellation thereof.

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(3). Where a certificate has been drawn up and subsequently the amount of the outstanding demand is reduced as a result of an appeal or other proceeding under this Act, the Tax Recovery Officer shall, when the order which was the subject-matter of such appeal or other proceeding has become final and conclusive, amend the certificate, or cancel it, as the case may be.

The term reduced in Sub-section(3) of Section 225 would include a case where the demand consequent upon an appeal or any proceedings under the Income-tax Act has been reduced to nil also. The Tax Recovery Officer is obliged to give effect to such reduction in demand and accordingly amend or cancel the certificate. The scheme of Part III of Second Schedule indicates

that the sale proceedings terminate on their becoming absolute whereafter all that remains to be done is the issuance of sale certificate. However, an order confirming the sale by the Tax Recovery Officer is a must. The efficacy of the sale by public auction in favour of the highest bidder has been made to depend on the order of confirmation by the Tax Recovery Officer by incorporating Rule 56 in the Schedule. It is true that ordinarily if there is no application filed for setting aside sale under Rules 60, 61 or 62 and 30 days from the date of the sale have expired, the Tax Recovery Officer has to make an order confirming a sale. Nevertheless, an order shall have to be actually made. The combined effect of Sub-section(3) of Section 225 of the Act and Rule 56 and Rule 63 of Second Schedule is that if before an order confirming the sale is actually passed by the Tax Recovery Officer, the demand of tax consequent upon an order made in appeal or other proceedings under the Act has been reduced to nil, the Tax Recovery Officer is obliged to cancel the certificate and as soon as the certificate is cancelled, he shall have no power to make an order confirming the sale. The sale itself being subject to confirmation by the Tax Recovery Officer, would fall to the ground for want of confirmation.

In the case at hand the sale was held on 11.1.1980. No application was filed for setting aside the sale either by the assessee or by the auction purchaser or by anyone interested in the property. On expiry of 30 days from the date of the sale the Tax Recovery Officer could have passed an order confirming the sale. However, the Tax Recovery Officer was injuncted by the writ of civil court from confirming the sale. The interim order issued by the civil court ceased to operate on 12.1.1998 whereafter an order of confirmation was passed on 25.3.1998 by the Tax Recovery Officer ignoring, or unmindful of, the important event which had taken place in between. Before 25.3.1998, the demand against the assessee admittedly stood reduced to nil. This fact was in the notice of Income-tax Officer as well as the Commissioner of Income Tax. Attention of the Income-tax Officer as also the Tax Recovery Officer was also invited by the firm M/s. UPCC through its communication dated 22.11.1996 (Annexure P- 6). On 16.1.1997, the counsel for the assessee had specifically called upon the income tax officer who had raised the demand against the assessee to confirm if all the recovery certificates issued against the assessee firm had stood withdrawn or cancelled. In view of the facts within the knowledge of the department and the communications so made, the Tax Recovery Officer could not have confirmed the sale on 25.3.1998. Rule 56 in Second Schedule of the Income-tax Act, 1961 is neither a redundant nor a formal provision. It casts an obligation on the Tax Recovery Officer to pass an order confirming the sale consciously and with due application of mind to the relevant facts relating to sale by public auction which is to be confirmed. Under Rule 63, confirmation of sale is not automatic. An order confirming the sale is contemplated to make the sale absolute. Ordinarily, in the absence of an application under Rule 60, 61 or 62 having been made, or having been rejected if made, on expiry of 30 days from the date of sale the Tax Recovery Officer shall pass an order confirming the sale. However, between the date of sale and the actual passing of the order confirming the sale if an event happens or a fact comes to the notice of the Tax Recovery Officer which goes to the root of the matter, the Tax Recovery Officer may refuse to pass an order confirming the sale. The fact that sale was being held for an assumed demand which is found to be fictitious or held to have not existed at all, in fact or in the eye of law, is one such event which would oblige the Tax Recovery Officer not to pass an order confirming the sale and rather annul the same. The High Court in our opinion, clearly fell in error in not allowing relief to the petitioner-appellant by setting aside the sale.

Shri S.K. Jain, learned counsel for the auction-purchaser, respondent No.3, referred to Janak Raj Vs. Gurdial Singh and Anr., (1967) 2 SCR 77 and Sardar Govindrao Mahadik and Anr. Vs. Devi Sahai and Ors., AIR 1982 SC 989 wherein it has been held that once a sale has taken place in execution of a decree, the sale has to be confirmed notwithstanding the fact that after the holding of the sale, the

decree was set aside. In Janak Rajs case, sale was held in execution of an ex-parte decree. The ex-parte decree was set aside subsequent to the date of the sale but before an order confirming the sale was passed. This court held that in the absence of an application for setting aside the sale having been moved on the grounds available under Rules 89 to 91 of Order 21 of C.P.C., the court could not have refused to confirm the sale. However, in this case itself, this court has observed (at page 80) that there may be cases in which apart from the provisions of Rules 89 to 91 the court may refuse to confirm a sale, as, for instance, where a sale is held without giving notice to the judgment debtor, or where the court is misled in fixing a reserved price or where there was no decree in existence at the time when the sale was held. In Sardar Govindrao Mahadiks case, Janak Rajs case was referred. The court has drawn a distinction between a court auction held in favour of a decree holder and where the auction purchaser is an outsider or a stranger. In former case on the decree ceasing to exist before the sale is confirmed, the sale may be refused to be confirmed but in the latter case, equity in favour of the stranger should be protected and the judgment debtor should be left to suffer for the default on his part for not obtaining stay of the execution of the decree from where it was under challenge. Though the learned counsel for the auction purchaser has relied heavily on these decisions, suffice it to observe that these are the cases of auction sale held under Order 21 of the C.P.C. and, therefore, may not apply to the case of an auction sale held under Second Schedule of the Income-tax Act in view of Rule 56 contained therein. Moreover, in these decisions also, the Supreme Court has contemplated situations where in spite of the auction sale having been held and no application for setting aside the sale having been moved, yet in exceptional situations the sale may be refused to be confirmed and may be set aside. Shri S.K. Jain also relied on Padanathil Ruqmini Amma Vs. P.K. Abdulla, JT (1996) 1 SC 381, wherein this court has observed that unless the auction purchasers were protected, the properties which are sold in court auctions would not fetch a proper price. It is true that sanctity of sale of property by public auction has to be protected but at the same time a citizen faced with proceedings for recovery of assumed arrears should not be deprived of his property in spite of judicial or quasi- judicial pronouncement holding, before the sale was confirmed, that there were no arrears. This observation applies a fortiori under the scheme of Income-tax Act, the relevant provisions whereof have already been referred to by us.

We now take up the second question.

Section 156 of the Act provides as under:-

156. Notice of demand.

When any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under this Act, the Assessing Officer shall serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable.

If the amount specified in the notice of demand under Section 156 is not paid within the time limited by sub-section (1) or extended under sub-section(3) of Section 220, then the assessee shall be deemed to be in default under sub-section (4) of Section 220. Tax recovery certificate can be issued under Section 222 when an assessee is in default or is deemed to be in default. Proceedings for recovery of tax under the Second Schedule can be initiated against a defaulter. Thus Section 156 provides for a vital step to be taken by the assessing officer without which the assessee cannot be termed a defaulter. The use of the term shall in Section 156 implies that service of demand notice is mandatory before initiating recovery proceedings and constitutes foundation of subsequent recovery proceedings.

We have already stated that the finding of fact recorded by C.I.T.(Appeals) and the Tribunal was that notice of demand was not served on the assessee. The very foundation for initiating the recovery proceedings, therefore, was non-existent and the assessee could neither have been deemed to be in default nor any proceedings for recovery of tax could have been initiated against him.

The provision corresponding with Section 156 of the Income-tax Act, 1961 contained in Section 29 of the Income-tax Act, 1922 came up for the consideration of this Court in Income-Tax Officer, Kolar Circle and Anr. Vs. Seghu Buchiah Setty - (1964) 52 ITR 538. Hidayatullah, J. (as His Lordship then was) held that it is after the demand is made, the tax penalty and interest become a debt due to the Government The notice of demand is a vital document in many respects. Disobedience to it makes the assessee a defaulter. It is a condition precedent to the treatment of the tax as an arrear of land revenue. His Lordship emphasised that the service of notice of demand has a few vital impacts amongst others : (i) when the notice of demand is not complied with, the assessee can be treated as a person in default; (ii) on the failure of the assessee to pay after a notice of demand is issued, the recovery proceedings can be started and the amount of tax can be treated as an arrear of land revenue. However, in this case Hidayatullah, J. went on to hold that if an assessment made by the Income-tax Officer is altered - reduced or increased - by reason of any order under the Act, it is the duty of the Income-tax Officer to issue a fresh notice of demand in the prescribed form and serve upon the assessee. This particular finding of Hidayatullah, J. created serious complications and resulted in nullifying several recovery proceedings, as also creating bottlenecks in the recoveries of outstanding demands. The Parliament, therefore, enacted Taxation Laws (Continuation and Validation of Recovery Proceedings) Act, 1964 which was given a retrospective effect. Section 3 of this Act provides that in the event of government demand being reduced by an order in appeal or other proceedings it shall not be necessary for the taxing authority to serve upon the assessee a fresh notice of demand, it would suffice if taxation authority intimated of reduction to the assessee and the Tax Recovery Officer to scale down the amount of recovery and the proceedings initiated on the basis of the previous notice of demand shall continue to be valid. To this extent the decision of this Court in Seghu Buchiah Setty was superseded.

In Homely Industries Vs. Sales Tax Officer, Sector V, Kanpur - (1976) 37 STC 483 also the significance of service of demand notice came up for the consideration of this Court and it was held that there can be no recovery without service of a demand notice; if such notice was not served, the recovery proceedings are not maintainable in law and are invalid and the same along with the recovery certificates are liable to be quashed.

In Ram Swarup Gupta Vs. Behari Lal Baldeo Prasad & Ors. - (1974) 95 ITR 339, a Division Bench of Allahabad High Court referred to the effect of Taxation Laws (CVRP) Act, 1964 on the law laid down by this court in Seghu Buchiah Settys case and held :-

The effect of these provisions is to dispense with the need of issuing a fresh notice of demand and the recovery certificate and to allow the original recovery proceedings to continue, but only for the amount found due after reduction in the appeal, and it is for this purpose that the taxing authority is required to send intimation of the fact of the reduction to the assessee and to the Tax Recovery Officer. As the proceedings for recovery can be continued only for the amount that finally remains due, and not for any amount in excess thereof, the requirement of sending intimation to the Tax Recovery Officer becomes an essential duty of the taxing authority and must be held to be a mandatory condition. Non-compliance of that condition will be an illegality in the procedure and will invalidate the proceedings. A sale held in proceedings initiated and continued for the recovery of an amount in excess of the amount payable by the assessee, after its reduction in appeal, will be

invalid. Such a sale is not validated by clause (c) of section 3 of the Act.

The Division Bench decision of Allahabad Court Court in Ram Swarup Guptas case was cited with approval before this Court in Union of India Vs. Jardine Henderson Ltd. - (1979) 118 ITR 112 though it was distinguished for its applicability to the facts of the case before this Court. The Division Bench of Orissa High Court has held in Sunil Kumar Singh Deo Vs. Tax Recovery Officer & Anr. - (1987) 166 ITR 882 that non-service of demand notice goes to the root of the jurisdiction of the officer initiating recovery proceedings. We find ourselves in agreement with the view so taken. Incidentally, we may refer to three Division Bench decisions of the High Court of Madhya Pradesh, viz., Ghanshyamlal Vs. State of M.P. - (1961) MPLJ SN 218, Manmohan Lal Shukla Vs. Board of Revenue, M.P. & Ors. - (1964) MPLJ 32 and Premchand Ramchand Vs. Board of Revenue, M.P. & Ors. - (1964) MPLJ 337. Section 146 of M.P. Land Revenue Code, 1959 provides that before issuing any process for recovery of arrears of land revenue the Tehsildar or Naib Tehsildar may cause a notice of demand to be served on any defaulter. Chief Justice P.V. Dixit speaking for the Division Benches, in all the three cases, has held that the word may has the imperative meaning of shall and no proceedings for recovery can be initiated without service of notice of demand failing which the proceedings would suffer from jurisdictional defect. For a long period of time the High Court of Madhya Pradesh has been taking this view consistently.

We are, therefore, clearly of the opinion that service of notice of demand on the assessee under Section 156 of the Act, is mandatory before taking steps for recovery under Second Schedule. Non-service of notice of demand goes to the root of the validity of subsequent proceedings for recovery. A sale held in recovery proceedings initiated without serving the notice of demand shall be invalid and hence shall be liable to be annulled on being called in question.

In Surinder Nath Kapoor Vs. Union of India & Ors. - AIR 1988 SC 1777 property was attached and sold pursuant to a garnishee order which was found to be non-existent on account of a nullity attaching thereto. The sale was set aside. This Court held :

the garnishee order that was passed was a nullity and any sale held pursuant to such an order is also a nullity. It is quite immaterial that the sale was confirmed. When a decree or order is illegal, any sale held in execution of such a decree or order and confirmed cannot be set aside on the ground that it was illegal when the sale is in favour of a third party. But, when a decree or order is a nullity, it will be deemed to have no existence at all and any sale held in execution of such a decree or order must also be held to be null and void.

In the present case, the plea as to non-service of demand notice having been raised before the High Court, in our opinion the High Court should not have adopted too technical a approach by refusing to deal with the plea because it was not raised in the manner in which the High Court thought it should have been raised. The plea went to the root of the matter. The plea was raised before the departmental authorities right from the ITO to the Tribunal and was not given up before the High Court also. It would not have been difficult for the High Court to ask the Income-tax Department to produce the record of the proceedings and to show if the demand notice was at all served on the assessee. A little more sensitive approach is required to be adopted in the process of dispensing justice when it is found that valuable property of a person was sought to be sold away for recovery of such arrears as did not exist at all.

Thus, on both the grounds, we hold that the sale of suit property in favour of respondent No.3 is liable to be set aside. The appeal is allowed. The impugned judgment of the High Court is set aside.

The writ petition filed by the appellant shall stand allowed. All the proceedings for the sale of the disputed property as also the order of the Tax Recovery Officer confirming the sale are hereby quashed.

The sale having fallen to the ground, the purchase money deposited by the respondent No.3 shall, obviously, be liable to be refunded to her. She also needs to be compensated by awarding suitable interest for the period for which she has been deprived of the use of her money for no fault of her. In our opinion, it would meet the ends of justice if the amount of Rs.1,70,000/- deposited by her with the Tax Recovery Officer is directed to be refunded and she is also awarded interest @ 12% per annum. Who should bear the liability for payment of interest? For the period for which the sale was not vitiated on account of the demand having not been adjudged to be non- existent, in our opinion, the assessee should pay the interest. Once the demand ceased to exist and that fact was brought to the notice of the Tax Recovery Officer by the assessee, the former should have cancelled the recovery certificate and, therefore, with effect from that date till the date of refund, the interest should be paid by the Union of India, i.e., the Income-tax department, represented by respondent nos. 1 and 2, which has also kept the money and made use of it. It is, therefore, directed that the amount of Rs.1,70,000/- shall be refunded to the respondent No.3 by the respondents No.1 and 2 within a period of two months from the date of this judgment. For the period commencing from 11.1.1980 on an amount of Rs.42,500/-, and from 25.1.1980, on an amount of Rs.1,27,500/-, calculating upto 22.11.1996 the appellant shall pay the interest @ 12% per annum to the respondent No.3 which may, in default of payment, be recovered from the house property. With effect from 23.11.1996 upto the date of refund, the respondent No.3 shall be entitled to recover interest at the same rate from respondents No.1 and 2. The amount of interest shall also be calculated and paid within a period of two months from today. We make it clear that the interest is being awarded pupurely on equitable considerations, in the facts and circumstances of this case, and in doing so we are not laying down any principle of law to be followed as a precedent. The appeal stands allowed in these terms. No order as to the costs.