RAJRATHA NARANBHAI MILLS. CO. LTD.

v.

SALES TAX OFFICER, PETLAD

FEBRUARY 19, 1991

[K.N. SAIKIA AND M.M. PUNCHHI, JJ.]

Companies Act, 1956: S. 530(1)(a)—State's claim to priority in relation to sales tax dues from a company in liquidation—Ambit of.

Expression 'having become due and payable within the twelve months next before the relevant date'—Meaning and scope of.

The appellant company was ordered to be wound up by Court's order dated 26.6.1967. The liquidator invited creditors to prove their debts or claims and to establish title, if any to determine priority under s. 530(1)(a) of the Companies Act, 1956. The Sales Tax Officer submitted a comprehensive claim of sales tax plus penalty and claimed priority. The liquidator rejected the claim for priority in its entirety but admitted a part of it payable as debt with other unsecured creditors.

The Revenue appealed to the High Court contending that the liquidator erred in law in not granting priority to the claim to sales tax payable by the company for the period from 1.4.1957 to 31.12.1965 under the Bombay Sales Tax Act, and for the period from 1.7.1957 to 31.12.1965 under the Central Sales Tax Act inasmuch as notice of demand was issued and assessment order was made in respect thereof within a period of 12 months before the relevant date.

The Company Judge, interpreting s. 530(1)(a) of the Act, held that tax becomes due when taxing event occurs and not when assessment orders passed; that even though the amount for which priority was claimed was the amount of tax arrears that became payable at the time of making assessment orders after giving credit for what was paid alongwith return, yet it was due for a period much prior to 12 months next before the relevant date, and rejected the appeal on that score, but allowed the claim to the extent of a small amount of penalty under the two Sales Tax Acts upto the relevant date.

The Revenue filed an intra court appeal, which along with another referred matter was heard by a Division Bench. The Division Bench held that sales tax becomes due and payable when the tax has

A been assessed and notice of demand for its payment is served. It allowed the claim of priority to the sales tax due under the two Acts, assessment orders in respect of which were passed within the period of 12 months immediately preceding 26.6.1967. The balance amount was directed to rank as ordinary debts since the relevant orders were passed after the date of winding up order. The claim of recovery of penalty was B negatived, because the demand was held to be without application of mind as to whether there was reasonable cause for the official liquidator for not paying the amount. Aggrieved, the company filed the present appeal by certificate.

Allowing the appeal, this Court,

C HELD: 1. Section 530(1)(a) of the Companies Act, 1956 provides that State has a priority over debts, liability and obligation of which was born within the time frame of 12 months next before the relevant date and as such due and becoming due and payable within those twelve months, ascertainable, if necessary, later if not already ascertained. D Thus the legal philosophy which permeats the provision is that the debts due and payable, so as to claim priority must be appropriated to the period within 12 months next before the relevant date and their liability for payment must be founded during that period and no other. [536G-H, 537A-B]

2.1 The words 'having become due and payable within the twelve E months next before the relevant date' occurring in clause (a) of s. 530(1) of the Companies Act need be understood to mean putting a restriction or cordoning off the amount for which priority is claimable and not in respect of each and every debt on account of taxes, rates and cesses, etc. which may be outstanding at that time and payable. And that such priority is in respect only of debts those of which became due and F payable because the liability to those is rooted, founded and belonging to that period of twelve months prior to the relevant date and none other; both the conditions existing. [537C-E]

Airedale Garage Co. In re: Anglo-South American v. *The Company,* [1832] Vol. 2 Company Cases 570, referred to.

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2.2 Both Benches of the High Court gave to the provision a very wide and varied interpretation and that too on literality and gramaticals. The Single Judge was not right in taking the view that the word 'due' in the first part of clause (a) of s. 530(1) of the Companies Act was to mean 'outstanding and payable at the relevant date' and in the expre- H ssion 'having become due' in the later part of the clause meant that the

event which brought the debt into existence occurred and also it became payable so as to be enforced against the company within twelve months before the date of order of winding up. The Division Bench erred in holding that the only meaning that could be assigned to the word 'due' occurring in the section was 'it must be presently due' and the words 'due and payable' meant that it must be presently payable. [536G, 531D-E & 532F-G] A

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Sales Tax Officer, Petlad **v.** *Rajratha Naranbhai Mills Co. Ltd. and Another*, **[1974] Vol. 44, Company Cases 65 and** *Baroda Board & Paper Mills Ltd. (in liquidation)* **v.** *Income Tax Officer etc,* **[1976] Vol. 46 Company cases 25, overruled.**

3. The liquidator was directed to re-examine the claim and to ascertain as to whether the liability to sales tax belonged to and was founded within the period of 12 months next before 26 June, 1967, and as such due and payable, but preserving the order of the Division Bench in relation to its view on penalties. [537E-G] C

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 2891 (NT) of 1977. D

Appeal by Certificate from the Judgment and Order dated 15.10.1975 of the Gujarat High Court in O.J. Appeal No. 2 of 1975.

B. Datta, P.H. Parekh and J.P. Pathak for the Appellant. E

Dushyant Dave, Anip Sachthey and Ashish Verma for the Respondent.

The Judgment of the Court was delivered by

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PUNCHHI, J. What is the ambit of the State's claim to priority in relation to revenues, taxes, cesses and rates, due from a company in liquidation, is the question which stands posed in this appeal by certificate, granted by the High Court of Gujarat, in O.J. Appeal No. 2 of 1975. The question arises on the frame of section 530(1)(a) of the Companies Act, 1956, as it stood at the relevant time, which is set out below: G

> "In a winding up, there shall be paid in priority to all other debts—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 H

A sub-section (8), and having become due and payable within the twelve months next before that date.

And sub-section (8)(c) of section 530 says:

"The expression 'the relevant date' means—(i) in the case B of a company ordered to be wound up compulsorily, the date of appointment (or first appointment) of a provisional liquidator, or if no such appointment was made the date of the winding up order, unless in either case the company had commenced to be wound up voluntarily before that date; and

C (ii) in any case where sub-clause (i) does not apply, the date of the passing of the resolution for the voluntary winding up of the company."

The appellant-company was ordered to be wound up by an order of D Court made on June 26, 1967. The liquidator after obtaining directions of the Court invited the creditors of the company to prove their debts or claims and simultaneously to establish any title they may have to priority under section 530. Pursuant to this invitation the Sales Tax Officer, Petlad submitted a comprehensive claim in the sum of Rs.70945.60 as the amount of sales tax plus penalty payable by the E company and claimed priority for the whole amount. The liquidator rejected the claim for priority in its entirety, but admitted claim to the tune of Rs.42143.63 payable as debt paripassu with other unsecured creditors of the company.

The Sales Tax Officer took the matter in appeal before the Com- F pany Judge under Rule 164 of the Companies (Court) Rules, 1959 which was heard by D.A. Desai, J. (as he was in the Gujarat High Court). It was urged on behalf of the Sales Tax Officer that out of the admitted claim in the amount of Rs.42,143.83, the liquidator was in error in not granting priority in payment of debt of Rs.22,280.96 consisting of Rs.11,064.46 being sales tax payable by the company for the G period from April 1, 1957 to December 31, 1965, under the Bombay Sales Tax Act and balance of Rs.11,216.50 being the amount of sales tax payable under the Central Sales Tax Act for the period from July 1, 1957 to December 31, 1965, because the assessment order was made in respect of the aforementioned claim within a period of 12 months next before the relevant date and the notice of demand which made H the tax payable was also issued within a period of 12 months next

before the relevant date. It was urged that apart from any other consideration the petitioner is entitled to a priority in payment for the amount of Rs.22,280.96 as the claim was of sales tax which was due on the relevant date and which became due and payable within 12 months next before the relevant date. It was conceded that balance of the admitted claim in the amount of Rs.19,862.87 being the amount of sales tax due and payable under the Bombay Sales Tax Act for the period from January 1, 1966 to June 26, 1967, would not be entitled to priority in payment. It was also conceded that the claim for an amount of Rs.196.42 had been rightly rejected. It would appeal that from the claim admitted as payable by the liquidator to the extent of Rs.42,143.83 priority in payment was claimed for the amount of Rs.22,280.96 on the submission that the claim represented the claim for tax payable to the State Government as it was due on the relevant date and had become due and payable within 12 months next before the relevant date, and therefore, it was entitled to a priority in payment as envisaged by section 530(1)(a) of the Companies Act.

The learned Judge on interpretation of section 530(1)(a) took the view that the word 'due' implies or conveys different meanings in juxtaposition in which it is used in the two parts of the same clause. The word 'due' in the first part of the clause must mean 'outstanding at the relevant date'. When it occurrs in the expression 'having become due' in the later part of the clause, it means that the event which brought the debt into existence occurred and also it became payable, meaning thereby that its payment could have been enforced against the company within the twelve months before the relevant date, that is, the date of the order of winding up. Three specific conditions are prescribed in the clause and all the three must co-exist and be satisfied in respect of any particular debt for which priority is claimed. The three conditions are:

(i) Debt of the kind mentioned in the clause must be outstanding on the relevant date;

(ii) The debt must have become due, in the sense that it must have been incurred at any time within the twelve months next before the relevant date; and

(iii) The debt must have become payable at any time within the twelve months next before the relevant date.

To conclude, the learned Judge observed that the tax becomes due

A when taxing event occurrs and not when assessment orders passed and that the claim for priority was rightly negatived by the liquidator because even though amount for which priority was claimed was the amount of tax arrears that became payable at the time of making assessment orders after giving credit for what was paid alongwith return, yet it was due for a period much prior to 12 months next before B the relevant date and even if it had become payable on the assessment order being made and demand notice being issued, as both the conditions did not co-exist and were not satisfied, claim for priority had been rightly nagatived by the official liquidator requiring no interference in his order. The appeal on that score was rejected but was allowed to the extent of a small amount of Rs.1225.36 being the amount of penalty under the Bombay Salex Tax Act and the Central C Sales Tax Act upto the relevant date and the liquidator was directed to abmit the said claim over and above the claim admitted by him. The judgment of the D.R. Desai, J. is reported as *Sales Tax Officer, Petlad* v. *Rajratha Naranbhai Mills Co. Ltd. & Another,* [1974] Vol. 44, Company Cases 65.

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An intra Court Appeal was preferred by the Salex Tax Officer, Petlad in the High Court. In the meantime in another case of Baroda Board & Paper Mills Ltd., a company in liquidation, the Income Tax Officer filed Company Application No. 2 of 1973 before the Company Judge claiming priority in respect of certain dues. The Company E Judge, B.K. Mehta, J. was engaged to determine the same question. His attention was invited to the decision of D.A. Desai, J. in the instant case. D.K. Mehta, J. was unable to agree with the conclusion reached by D.A. Desai, J. and hence the matter was referred to a Division Bench to have the entire question decided along with O.J. Appeal No. 2 of 1975.

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The division bench of the High Court differed from the view of D.A. Desai, J. by holding that the only meaning that could be assigned to the word 'due' occuring in the section is 'it must be presently due' and the words 'due and payable' mean the same thing, namely, that it must be presently payable. On this understanding it was held that all G revenues, taxes, cesses and rates due from the company to the Central or State Government or to a local authority must be presently payable, that is, that the liability could be enforced as at the relevant date and, secondly, it must have so become presently payable within twelve months immediately preceding the relevant date. Further regarding sales tax it was held that it becomes due and payable when the tax has H been assessed and a notice of demand for payment of that tax is served

upon the assessee or the dealer concerned and it is in this sense that the word has to be interpreted. Taking that view the appeal of the Sales Tax Officer was allowed inasmuch as the sales tax due under the Bombay Sales Tax Act and the Central Sales Tax Act in respect of which the assessment orders were passed within the period of twelve months immediately preceding June 26, 1967 were held to have priority. The balance amount as dues was directed to rank as ordinary debts without any priority, since the relevant orders were passed after the date of the winding up order. The claim of the Sales Tax Officer to the recovery of penalty in liquidation proceedings was negatived because the demand was held to be without application of mind as to whether there was reasonable cause for the official liquidator for not paying the amount. O.J. Appeal No. 2 of 1975 was allowed to this extent. The Judgment of the High Court is reported as *Baroda Board & Paper Mills Ltd. (in Liquidation)* v. *Income-Tax Officer etc.*, [1976] Vol. 46 Company Cases 25. Clash of interpretations of section 530(1)(a) is the cause in this appeal.

We have gone through both the judgments afore-referred to very carefully and minutely and have heard learned counsel on the conflicting decisions. There are wide ranging discussions in the interpretative process relating to the word 'due' occuring in the earlier part of the provision and the words 'due and payable' in the later part, and whether they are different expressions meant to convey differently or they mean the same thing. With due respect to the High Court, we feel that relevant and important considerations and material though available, which could go to interpret the section purposively was overlooked, and at this juncture we wish to put it to use.

Section 530 of the Companies Act, 1956 is the same as section 230 of the Indian Companies Act, 1913. The old section 230(1)(a) of the Indian Companies Act, 1913 was analogous to Section 261 of the English Companies Act laying down that there shall be priority on certain debts named therein. In *Airedale Garage Co. In re: Anglo-South American Bank* v. *The Company*, [1932] Vol. 2 Company Cases 570 in the Court of Appeal, Lord Hanworth, Master of Rolls explained the meaning of the provision at page 574 in the following words:

> "Now section 264 says that in the winding up of a company 'there shall be paid in priority to all other debts' certain debts, namely, 'parochail or other local rates ..... assessed taxes ..... property or income tax .... wages or salary of any clerk or servant 'during four months next before the

A relevant date .... not exceeding fifty pounds,' and others, and it is these debts which are to be marshalled and paid in accordance with the priority given to them by section 264. With regard to local rates it is provided that priority shall be given to 'All parochial or other local rates due from the company at the relevant date'—the relevant date being the B date of the appointment of the receiver, in this case, January 28, 1931—'and having become due and payable within twelve months next before that date'. Those words are put in to restrict the amount for which priority is given. It is not priority in respect of all the debts for local rates which maybe outstanding at that time; the priority is in re- C spect only of such rates as became due and payable within twelve months before, in this case, January 28, 1931."

And further at pages 577-78 as follows:

D "The rate was made on April 1, 1930; at that time it became due and payable. The alteration that has been made subsequently in September of the year 1931 is to fit into the section to which I have referred, and by that section it is to be deemed to have had effect as from the commencement of the period in respect of which the rate was made. In E those circumstances it seems quite plain that the sum in contest in the present case must be appropriate to that period and that period alone, and, although ascertained at a later date, it nonetheless belongs to and is founded upon the liability to rates during that period and no other. I find myself, therefore, unable to give a limited meaning to the F words, as Eve, J., has done. I think the words referred to in section 264 of the Companies Act, 'due and payable', meant to refer to a liability in respect of which there had to be a solution—*Solvendum in futuro*—of that particular debt, and that particular debt is now to be deemed to have accrued within the period of the twelve months next before the relevant date."

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In A. Pamaiya's the Companies Act, Eleventh Edition, 1988, it has been noticed at page 1320 that Section 530 of the Companies Act, 1956 has been largely recast and amended in the light of the following recommendations (exerpted) of the Company Law Committee in H paragraph 218 of their Report:

"Section 230 of the Act of 1913 deals with the important subject of preferential payment. The principle underlying this section is that the debts and liabilities enumerated in it should be treated as preferential debts as compared with ordinary unsecured debts. The rights of secured creditors other than debenture-holders secured by a floating charge are not affected in any way. They remain outside the scope of the winding-up proceedings and their security remains unaffected by the provisions of this section. We have set out in the Annexure to our Report the details of our recommendations, which broadly follow the provisions of the English Companies Act. Briefly, the more important of these recommendations are as follows:

(i) xxxxx

(ii) xxxxx

(iii) xxxxx

In this connection we should like to refer to a memorandum that we received from the Central Board of Revenue, on the question of a priority to be given to crown demands generally and, in particular, to arrears of income-tax, super tax and corporation tax. It was suggested that there should be no time-limit for the preferential payment of these crown debts and that section 230 of the Indian Companies Act should be amended accordingly. The practical difficulty of giving effect to the suggestion is that it would place a great majority of the unsecured creditors of the company at the mercy of the income-tax authorities, inasmuch as, whatever may be the nature of the security on which they may have lent money to a company at the time of the loan, the unforeseeable demands of the income-tax authorities on the company without any time-limit would rank over the claims of such creditors. In these circumstances, it may be extremely difficult for the company to raise capital for its working. In this connection, we would draw attention to the provisions of clause (a) of sub-section (1) of section 319 of the English Companies Act, 1948, under which arrears of land tax, income-tax, profits tax, excess profits tax or other assessed taxes rank in priority over other debts of a company only if they have been assessed on the company up to a particular date, namely, 5th

A April or prior to the appointment of the liquidator or resolution for the winding up of the company and do not exceed in amount the whole of one year's assessment. It will be noticed that by comparison the provision of clause (a) of sub-section (1) of section 230 of the Indian Companies Act, is much wider and gives much more latitude to the income-
B tax authorities for under these provisions, arrears to taxes would rank in priority if they have become due and payable within twelve months next before the date on which they are payable irrespective of whether such taxes have been assessed on the company or not. We are aware of the large arrears of income and other taxes which are due by many companies, which are in liqudation, but we would venture
C to think that the remedy for this unsatisfactory situation is not the conferment of preferential rights without limit to the income-tax authorities under section 230 of the Indian Companies Act, but the energetic completion of assessment proceedings and vigorous measures for the collection
D of the assessed taxes."

In Pennington's Company Law, Fourth Edition, Chapter 26 titled 'Rules Common to All Liquidations; occuring under the head "Preferential Claim and Payments" at page 768 it is observed as follows:

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"The Inland Revenue may select the unpaid corporation or income tax for any one year as its preferential claim, and is not restricted to claiming the tax for the most recent year which ended on or before April 5 immediately preceding the relevant date. Moreover, when there are two or more
F kinds of unpaid taxes, the Crown may select different years for different taxes, but since advance corporation tax is paid as an advance instalment of the company's liability for corporation tax for the accounting period in which the advance corporation tax falls due, it would seem that the Inland Revenue may claim preference for both advance
G corporation tax and mainstream corporation tax only in respect of the same year.

Both benches of the High Court, with due respect, gave to the provision a very wide and varied interpretation and that too on literality and grammaticals seemingly overlooking the legal philosophy
H which permeats the provision, the same being that the debts due and

payable, so as to claim priority, must be appropriated to the period within 12 months next before the relevant date and their liability for payment must be founded during that period and no other. To put it in simpler words, the State has a priority over debts, liability and obligation of which was born within the time frame of those twelve months and as such due and becoming due and payable within those twelve months next before the relevant date, ascertainable if necessary later, if not already ascertained. We are in respectful agreement with the interpretation put by the Court of Appeal to section 264 of the English Companies Act in *Airedale Garage's* case (supra), analogous as it is to the provision in hand, warranting the same interpretation; more so when any other interpretation would lead to the results feared by the Company Law Committee extracted above. In such view of the matter, we need not elaborately comment, discuss or demolish, sentence by sentence, the reasoning given by the single bench as also the division bench of the High Court towards interpreting the provision. The words 'having become due and payable within 12 months next before the relevant date' need be understood to mean putting a restriction or cordoning off the amount for which prioirty is claimable and not in respect of each and every debt on account of taxes, rates and cesses etc. which may be outstanding at that time and payable. And further that such priority is in respect only of debts those of which become due and payable because the liability to those is rooted, founded and belonging to that period of twelve months prior to the relevant date and none other; both the conditions existing.

A B C D E

For the view above taken, we allow the appeal of the Company in liquidation and direct that liquidator to re-examine the claim for priority in accordance with the interpretation of the provision put by us, that is to say, he must first ascertain as to whether the liability to sales tax belongs to and is founded within the period of 12 months next before 26 June, 1967, and as such due and payable but preserving, however, the order of the division bench in relation to the view it has taken about penalties. In the facts and circumstances of the case, we order that there should be no order as to costs.

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R.P. Appeal allowed.

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