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Court : Chennai

Decided On : Aug-02-2001

Reported in : [2001]253ITR139(Mad)

Appeal No. : Write Appeal No. 319 of 1998 2 August 2001

Appellant : C. Rajendran and Another

Respondent : ito

Advocate for Pet/Ap. : P. P. S. Janarthana Raja for N. C. Ramesh and P. Thiagarajan *for the Assessee* T. Ravikumar *for the Revenue*

Judgement :

V. S. Sirpurkar, J.

This writ appeal is filed against the order of the learned Single Judge, who has refused to entertain the writ petition filed by the petitioners. A few facts would be necessary.

The petitioners are the directors of a private limited company called Anaimugham Transport Private Limited. There was tax liability against this company for the assessment years 1974-75 and 1978-79. The tax liability for the assessment year 1974-75 was Rs. 18,855 while the tax liability for the assessment year 1978-79 came to Rs. 3,58,174. A notice came to be served to the directors of the company,

the petitioners in the writ petition, under section 179(1) of the Income Tax Act, 1961. By that notice, it was informed to the company that the company was in tax arrears for the aforementioned two assessment years in the sum of Rs. 27,347 and Rs. 3,25,976, respectively. In addition to these amounts, the company was also liable to pay interest under section 220(2) of the Income Tax Act as also penalty under section 221. It was then pointed out that the tax arrears could not be collected from the company and the non-recovery of the tax was attributable to the gross negligence on the part of the directors, i.e., the noticees and, therefore, the noticees were directed to show cause as to why they could not be held jointly and severally liable for the payment of the tax arrears and this notice seems to have been answered by one Chandrasekara Mudaliar, managing director of the company, who pointed out that a waiver petition was pending in respect of the interest under section 139(8) of the Income Tax Act as the arrears for the assessment year 1974-75 were only on account of the interest liability. As regards the assessment year 1978-79, it was pointed out by the petitioners that the company had preferred an appeal against that liability and the said appeal was already pending. It was, therefore, prayed that the proposed action under section 179 of the Income Tax Act should be stayed during the pendency of the appeal.

2. It seems that the Income Tax Officer, by his order dated 7-1-1988, came to the conclusion that the taxes due from the assessee-company could not be recovered from the company and that Chandrasekara Mudaliar was the managing director while Rajendran and Surendran were the directors of the company during the relevant years and that they would be jointly and severally liable for the above mentioned tax arrears and the interest in terms of section 179(1) of the Income Tax Act.

This was objected to by filing a writ petition before the learned Single Judge. However, the learned Single Judge took the view that the respondent was justified in holding that the petitioners were liable under section 179(1) of the Income Tax Act. The learned Single Judge seems to have relied upon the judgment of Srinivasan J. (as his Lordship then was) in M. R. Sundararaman v. CIT : [1995]215ITR9(Mad) . That is by far the only ground on which the writ petition was rejected.

3. Learned counsel for the appellant draws our attention to the order passed by the learned Single Judge and points out that the aforementioned judgment in Sundararaman's case (supra) pertained only to the aspect of retrospectivity of section 179(1) of the Income Tax Act. Learned counsel says that it is not his argument that the tax arrears for the past assessment years could not be recovered with the aid of the concerned provision. He points out that the learned judge has not considered the main argument to the effect that for activating section 179 and for holding the directors jointly and severally liable for the payment of the tax arrears against a private limited company, it must first be found that the tax cannot be recovered from the said company. Learned counsel points out that the only effort which has been made for recovery of tax arrears is by way of a show-cause notice under sections 221 and 222 of the Income Tax Act which would be apparent from the contents of paragraph 4 of the order passed by the Income Tax Officer. According to learned counsel that by itself cannot meet the requirement of the section. Learned counsel for the department has candidly admitted that besides the notices given to the company under sections 221 and 222 no other actions have been initiated for the recovery of the tax arrears. It will be now our endeavour to consider these rival contentions.

It will be better to quote section 179 of the Income Tax Act for that purpose. Section 179(1) reads as follows :

'Liability of directors of private company in liquidation. -(1) Notwithstanding anything contained in the Companies Act, 1956 (1 of 1956), where any tax due from a private company in respect of any income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax unless, he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to' the affairs of the company.'

This section has been amended and it is the amended version which is reproduced above. The language of the section is very clear to suggest that the

action under the section can be activated only when the tax due from a private limited company pertaining to the previous year cannot be recovered. The words 'cannot be recovered' are most important. The phraseology suggests essentially that in spite of the efforts made as per the procedure followed in the Income Tax Act for recovery of the tax arrears when the said tax arrears cannot be recovered then alone the liability can be transferred under section 179(1) of the Income Tax Act to the directors. Therefore, in order to activate this section and the action thereunder, a finding would have to be recorded to the effect that in spite of the efforts to recover the tax arrears the said tax arrears could not be recovered from the assessee-company. The second part of the section comes into effect only thereafter. Firstly, once there is a finding that such tax arrears cannot be recovered then the liability could be transferred to every person who was a director and it would be then for such a person to show that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company and when he discharges this burden, he would no more be required to discharge the tax liability so transferred to him. However, that stage would come only later on, after it is found that the tax arrears cannot be recovered from the assessee-company.

Learned counsel points out to us that in the first place, in so far as the assessment year 1978-79 was concerned, an appeal was pending and, therefore, tax liability itself had not become final. We are not impressed by this argument because it is admitted before us that in the appeal there is no stay order in favour of the company. Once there is no legal impediment for recovery by way of stay order, the tax arrears are always recoverable and ultimately if it is found that the tax arrears cannot be recovered, section 179 could always be activated. In fact, this argument was made before the learned Single Judge also and, in our opinion, the learned judge has correctly observed that the recoveries could be made only to the extent of the tax arrears or the tax liability found finally in the appeal or revision, as the case may be. However, learned counsel for the appellant then points out that there was no effort to recover the tax arrears and the finding given by the concerned authority is not based on sound material. Our attention is invited to paragraph 4 of the order where there is a mention to the show-cause notice under section 221 having been given to the assessee-company. There is also a mention of some

letters whereby the company was directed to pay the tax arrears immediately. Then the authority mentions :

'In so far as the assessee-company failed to pay the tax, proceedings under section 179(1) of the Income Tax Act were initiated against 1. Shri M. Chandrasekara Mudaliar, managing director, 2. Shri C. Rajendran, director, and 3. Shri C. Surendran, director of the company, holding them jointly and severally responsible for the arrears outstanding for the assessment years 1974-75 and 1978-79.'

Learned counsel points out from this phraseology that it was on 'failure of the assessee-company to pay the tax arrears' that the proceedings under section 179(1) of the Income Tax Act were initiated. Learned counsel further points out that beyond this, there is no finding by the authority that the tax arrears 'cannot be recovered' from the company and, therefore, the liability to pay the tax arrears would be transferred to the directors. In our view, learned counsel is right in making this submission. The language of the provision warrants that there has to be a proper finding regarding the recovery of tax arrears being 'not possible' from the assessee-company. Such a finding cannot be casually given merely on the basis of the notice under sections 221 and 222 of the Income Tax Act and/or for that matter some letters by which the company is asked to pay its tax arrears. A detailed enquiry has to be made and a definite finding has to be given to the effect that the tax arrears cannot be recovered from the company. On seeing the orders, we do not see any such effort having been made by the concerned officer. All that the concerned officer has mentioned is that there have been some notices under sections 221 and 222 of the Income Tax Act. That, according to us, would not be sufficient to write a finding regarding the tax arrears not being recoverable from the company.

4. Our attention was drawn by learned counsel for the appellant to the Division Bench judgment in K V. Reddy v. Asst. CIT : [1998]232ITR306(AP) . The Division Bench has taken a similar view therein. The Division Bench observes (page 308) :

'The language used in the section is clear. It is only in cases where the tax cannot be recovered from the company that the liability of the director arises. The liability

of the directors is joint and several. It is not a joint and several liability with the company. It is not a liability co-extensive with the liability of the company, unlike a principal debtor and the surety. In the case of the principal debtor and surety the liability of the surety is co-extensive with that of the principal debtor and, therefore, both the principal debtor and the surety can be proceeded against simultaneously. Whereas under section 179 of the Act it is only in case the tax cannot be recovered from the company that the liability of the director arises or the liability itself arises for the director. After that liability arises, the liability is joint and several amongst the directors and it is not a liability joint and several with that of the company.

Therefore, before the assessing officer proceeds against the directors personally he has to give a finding that the income-tax due for the previous year cannot be recovered from the company. In the absence of giving a finding conferring jurisdiction on him to recover the income-tax from the director personally, the assessing officer does not get the jurisdiction to initiate proceedings under section 179 of the Act. In the absence of such a finding, the assessing officer does not get jurisdiction to invoke the provisions of section 179 of the Act.'

We respectfully agree with the Division Bench of the Andhra Pradesh High Court. On this backdrop when we see the impugned order, it is obvious that there have been no efforts made to recover the tax arrears from the assessee-company and the finding has also not been properly recorded.

It was tried to be argued by learned standing counsel for the revenue that this company is in deep financial troubles and at any rate, the tax arrears would not be recoverable from the said company. We do not want to venture into that enquiry. It would not be our task. It would be for the department to prove the impossibility of the recovery of the tax arrears from the assessee-company before the concerned officer by putting relevant material and not merely relying upon the notices issued under section 221 and section 222 of the Income Tax Act. It would be, therefore, better to remand the matter to the concerned authority who would consider all the aspects and then come to the conclusion regarding the proceeding under section 179(1) of the Income Tax Act and the resultant action thereof. However, the

concerned authority shall be guided by the observations made by us in this order.

With this, we partly allow the appeal, set aside the order of the learned Single Judge as also the order passed at the first instance dated 7-1-1988, and direct the concerned officer to decide the question again in the light of the observations made by us. No costs.